

A Critical Analysis of Investor Protection under Saudi Stock Market Regulations

**By
Mohammed Sulaiman Aleid**

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**School of Law
University of Essex**

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Abstract

As the government of Saudi Arabia begins a major evolutionary process of economic expansion, the Saudi stock market has become the focus of increased attention. The legal framework that regulates the stock market is still considered to be underdeveloped, as only recently, in 2003, did the Saudi legislator issue a Capital Market Law (2003) and create a regulatory body vested with its enforcement.

The securities market was built around this legislation, which helped to stimulate the economy by attracting investor. However, the Saudi stock market experienced a big crash in February 2006, which had a profound impact in heavy losses for large and small investors. The practical application of these new laws brought to light some shortcomings in the regulations of the stock market, and specifically, the need for the legal protection of investor.

Hence, the overarching aim of this thesis is to focus particular on four issues: on the question of whether or not the existing regulations of the Saudi stock market adequately protects investor from poor disclosure, insider trading and market manipulation induced partly by market brokers. Thus, there are four primary objectives of this thesis: to enhance the effectiveness of existing rules to secure a suitable level of protection for investor against poor disclosure, market abuse and illegal practices by broker; to increase investor confidence and attractiveness of the market; to prevent a future repeat of the stock market collapse and avoid the steps that caused it; and finally, to provide useful material for Saudi Capital Market Law (2003) reforms in the future.

In order to examine these sensitive issues, the thesis will first examine whether or not the disclosure regulations of the Saudi stock market provide adequate protection to investor and secondly assess the effectiveness of the legal framework of insider trading regulations for preventing insider trading. Third, it will ascertain how well the the law defines market manipulation and covers the most common forms of market manipulation under Saudi securities law. Lastly it will explore the responsibility that brokers in the Saudi stock market have to achieve the greatest degree of protection for investor.

List of Abbreviations

CESR	Committee of European Securities Regulators
CJA	Criminal Justice Act
CMA	Capital Market Authority
COB	The FSA's Rulebook, Effective Until 2007
COBS	The FSA's Conduct of Business Sourcebook, Effective from 2007
CRSD	Committee for the Resolution of Securities Disputes
CSBD	Committee for the Settlement of Banking Disputes
EUR	Euros
FCA	Financial Conduct Authority
FSA	Financial Services Authority
FSMA 2000	Financial Services and Markets Act
GCC	Gulf Cooperation Council
IASB	International Accounting Standards Board
IMF	International Monetary Fund
IOSC	International Organization of Securities Commission
IPO	Initial Public Offering
LR	Listing Rules
LSE	London Stock Exchange
MAR	Market Abuse Regulations
MifID	The Markets in Financial Instruments Directive
NASD	The US National Association of Securities Dealers
Principles	The FSA's Principles for Business
SAR	Saudi Arabian Riyal
SEC	Securities Exchange Commission (USA)
SROs	Self-regulatory Organizations
SSM	Saudi Stock Market
UK	United Kingdom
US	United State of America

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Chapter 1: Introduction

1.1 Research Aims and Objective

The aim of this thesis is to provide a regulatory analysis of the existing regulations of the Saudi stock market, in order to examine whether these regulations provide investor with adequate protection, and subsequently restore their confidence in the stock market as a whole.

Thus, there are four primary objectives of this thesis: to enhance the effectiveness of existing rules to secure a suitable level of protection for investor against poor disclosure, market abuse and illegal practices by broker; to increase investor confidence and attractiveness of the market; to prevent a future repeat of the stock market collapse and avoid the steps that caused it; and finally, to provide useful material for Saudi Capital Market Law (2003) reforms in the future.

The Saudi Capital Market Law (2003) and its associated regulations were introduced and legislated with similar objectives in mind. However, this thesis will focus specifically on four key issues. These issues were selected for three reasons: firstly, they are key targets for regulations in virtually every country and considered to be key elements of protection for investor. Secondly, these factors may be considered a cause of the collapse of the Saudi stock market. And finally, this thesis argues that these four issues still present substantial problems for the current regulations of the Saudi stock market (SSM) from an investor's protection perspective. The four issues are as follows:

(1) The lack of transparency and disclosure by listed companies was one of the most important lessons taken from the collapse of the Saudi stock market (SSM) in 2006, as proper and effective disclosure regulations are required in order to afford proper protection to investor. Information disclosure is a key factor in their investment decisions.

(2) Saudi Arabia has not been absolved from insider trading, as indicated by the

crash of the Saudi stock market. A situation such as this demands the creation of clear, strong standards for the maintenance of transparency and the prevention of the diversion of information, as such so justice amongst investor can be realized. The absence of regulations that would protect investor from practices such as insider trading would endanger the stability of these markets. Accordingly, this thesis aims to answer the question as to whether the regulations of insider trading in the Saudi stock market (SSM) protects investor from insider dealing.

(3) Market manipulation causes detrimental damage to the fairness and integrity of the stock market, and thus weakens investors' confidence in it. Consequently, Saudi's capital authority market must enforce adequate systems that are able to detect, investigate and prosecute market manipulation in order to protect investor, ensure durability and make the market immune to another financial crisis. Therefore, this thesis assesses the current system of regulatory market manipulation in Saudi Arabia and debates whether it is adequate for the intended purpose.

(4) Brokers are deemed significant in the process since they work as intermediaries who arrange on behalf of investor the sale and purchase of shares. In well-functioning stock markets, it has long been considered that a broker should conduct its client's transactions with due skill, care and diligence in accordance with sensible practice in the brokerage business. Therefore, it is argued, that stock markets were established; to restrict entrance to stock markets to brokers in order to guarantee the conduct of its members and to limit fraudulent practices. Therefore, it can be argued that the behaviour of brokers can affect the health of stock market. Thus, one of the main aims of this thesis is to conduct an evaluation of regulatory duties provided by regulations regarding the brokerage business, in order to protect investor in the stock market.

This thesis will have a particular focus on four selected issues: on the question of whether or not the existing regulations of the Saudi stock market (SSM) adequately protects investor from poor disclosure, insider trading and market manipulation induced partly by market brokers. In order to examine these sensitive issues, the researcher will analyze and evaluate several fundamental concepts and address some crucial questions.

- The thesis will first examine whether or not the disclosure regulations of the Saudi stock market (SSM) provide adequate protection to investor, which can be found in the Companies

Act 1965, Listing Rules and Corporate Governance regulations. Do Existing Penalties Ensure Proper Implementation of Disclosure Rules? (Chapter 3)

- Assess the effectiveness of the legal framework of insider trading regulations (Market Conduct regulations) for preventing insider trading. To do so, the following questions must be answered: ‘Who is an insider?’ ‘What is inside information?’ ‘How is inside information transferred?’ ‘What actions are banned?’ ‘What is the theoretical basis for the imposition of sanctions against insider trading?’ ‘Enforcing civil or criminal sanctions?’ ‘Do enforcement mechanisms contribute to the effective implementation of insider dealing laws?’ (Chapter 4)
- How well does the Saudi market enforce the Market Conduct regulations that define market manipulation? ‘To what extent do the laws of the Saudi stock market consider the most common forms of market manipulation?’ ‘Will intent be an obstacle for enforcing the Law?’ ‘Can enforcement be effective with the existing regulatory gap?’ (Chapter 5)
- Finally, it will explore the responsibility that brokers in the Saudi stock market have to achieve the greatest degree of protection for investors; the regulations under consideration is Authorised Persons regulations. To do so, the following questions need to be answered: ‘Is broker a source of market manipulation?’ ‘Do broker owe fiduciary duty?’ ‘How does a broker provide suitable recommendations to his/her client?’ ‘What is the significance of suitability in stock market under its regulations?’ What is the responsibility of broker under Saudi Law?’ (Chapter 6).

1.2 Research Significance

In this thesis the researcher will analyze, evaluate, and propose to the Saudi stock market regulations, in order to examines whether or not the existing regulations provide adequate protection for investor and restored investors’ confidence in it. Therefore, the main motive behind the selection of this subject is explained in the light of the following:

Firstly: As increasing numbers of the public become aware of the value to both themselves and to their nation to be had from investing in local stock market, a case in point is the Saudi Arabian economy, wherein the lack of alternative investment opportunities contrasts with the huge financial surpluses generated by successive increases in oil prices and the return of a

considerable proportion of national migratory savings after September 2001. Saudis' interest in their national stock market began at the end of 2002 and early 2003 with the initial public offering (IPO) of STC shares. Such offers prompted individual investor to continue investing in the stock market given the large profits that they earned. At that time, the Saudi investment population did not extend beyond 50,000 because most of the Saudi investor were the elderly and people with experience in business, and in view of universally low interest rates on 'safe' investments.¹

Secondly, there is also an even stronger reason to advance and develop the regulatory framework in Saudi stock market. As long as the existing regulatory structures are seen to be weak the market is open to financial crises with reference to the big crash that witnessed by Saudi stock market in February 2006 As a result of that Saudi stock index prices lost 52% of their value, and Saudis lost confidence in the capital market. moreover, inadequate regulatory capacity will provide the potential for an illegal practice in particular to the smaller investor.² Where rules against market manipulation, insider trading and asymmetries of information are seen to be avoidable and ineffective, institutional and large investor will take advantage of the smaller ones.

Thirdly: An additional need for regulatory reform in Saudi securities market arises from the imminent likelihood of wholesale privatization of hitherto state or community-owned utilities across the region. Saudi Arabia have already, and is likely to continue in the near future, to privatize sensitive areas such as Saudi Arabian Oil Company (Aramco)³ and water and other. Investor in newly privatized companies will certainly need efficient and robust protective regulations and accountability standards to ensuring the conduct of such businesses or the entire economic structure of each state is not put at risk. Claessens et al. find that privatization programs support stock market growth⁴. Additionally, Perotti and Oijen claim that privatization

¹ Abdulrahman Y Baamir, 'Issues of Transparency and Disclosure in the Saudi Stock Market' (2008) 22 Arab Law Quarterly 63.

² Saudi Stock Exchange 'Tadawul', 'Annual Report' (2006).

³ Saudi Arabian Oil Company, most popularly known just as Aramco, is a Saudi Arabian national petroleum and natural gas company. Saudi Aramco's value has been estimated between US\$1.25 trillion and US\$10 trillion, making it the world's most valuable company

⁴ Stijn Claessens and others, 'Stock market in Transition Economies' (2000).

has an indirect positive effect on stock market growth within political risk reduction⁵.

Once privatization is an established fact, securities market will find large numbers of companies seeking a listing and a step change in the volume of securities trading. It will be a major test for governments to construct a regulatory framework that encourages economic growth and that raises living standards for all levels of society during the first decades of the twenty-first century. Saudi Arabia is trending towards encouraging foreign investment and giving foreigners access to its markets. As CAM took further steps to open up its stock market to foreigners (Saudi stock market has opened to foreign investor Qualified (QFIs) on June 15, 2015) in a move that may help it get included in a key index of developing-nation equities. Therefore, the kingdom must therefore revise and modernize its regulatory regimes.

The first thing that Capital Market Authority (CMA) must do is build a solid, well-considered and robust body of regulations that gives reasonable legal protection to those who make investments and set up businesses within the states. In order to attract foreign investment, it is essential to have a well-developed legal framework that would ensure the minimal protection for such investments. Second, the Saudi market, if compared with the developed markets, is limited in size. Thus, the absence of regulations that would protect national industries and investor from practices such as insider trading and market manipulation would endanger the stability of these markets. Finally, the institutional infrastructure of the market will be examined, along with the cultural and social characteristics of the investor whenever these factors are appropriate and relevant.

1.3 Literature Review

The present section reviews the literature relevant to the research objectives and frames this study in rapport with the literature. Subsequent parts of the study will address the research findings and related literature in greater depth.

⁵ Enrico C Perotti and Pieter Van Oijen, 'Privatization, Political Risk and Stock Market Development in Emerging Economies' (2001) 20 *Journal of International Money and Finance* P43.

The factors contributing to successful capital markets have been discussed by many studies. Despite the interdisciplinary nature of the current literature, wide agreement exists among both academics and governmental about a number of aspects⁶. These aspects include the necessity to have quality information about business value and the necessity to ensure the protection of minority shareholders against activities like insider trading⁷. Despite being of relevance to the Saudi capital markets, general literature has to be adapted to the particular context of Saudi Arabia due to the singular characteristics of the Saudi environment.

The research performed yielded only a small number of academic and institutional studies on Saudi Arabian Capital Markets. Examples include: Firstly: a 2010 study prepared by Al Jazira Capital under the title: 'Financing Role of the Saudi Capital Market: Promising Prospects';⁸ Secondly: a 2009 study conducted by the World Bank concerning the application of corporate governance practices in Saudi Arabia;⁹ Thirdly: a 2006 study conducted by the International Money Fund concerning the stability of Saudi Arabian financial system;¹⁰ Fourthly: a book chapter titled 'The Saudi Capital Market' written by Mohammed Ramady in his 2005 book 'The Saudi Arabian Economy: Policies, Achievements and Challenges';¹¹ and Finally: a 2002 conference paper written by Abdulaziz Al-Dukheil under the title: 'The Saudi Stock Market'¹².

Such studies are helpful for understanding how the Saudi capital market institutions developed and what their existing situation is, as well as for understanding the socio-economic conditions in which those institutions operate. On the other hand, the studies do not address the revision of the doctrine underlying the regulatory framework.

However, just three studies investigating the general regulatory framework underlying Saudi

⁶ Bernard S Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2000) 48 UCLA L Rev 781.

⁷ Abdullah Ibnrubbian, 'Effects of Regulation, Islamic Law and Noise Traders on the Saudi Stock Market' (A Thesis Submitted for the Degree of Doctor of Philosophy, Brunel University 2012).

⁸ Al Jazira Capital, 'Financing Role of the Saudi Capital Market: Promising Prospects' (2010).

⁹ International Monetary Fund, 'Saudi Arabia: Financial System Stability Assessment, Including Reports on the Observance of Standards and Codes on the Following Topics, Monetary and Financial Policy Transparency, Banking Supervision, and Payment Systems' (2006).

¹⁰ IMF, 'Saudi Arabia: Financial System Stability Assessment' (IMF Country Report No. 06/199, June 2006).

¹¹ Mohamed A Ramady, *The Saudi Arabian Economy: Policies, Achievements, and Challenges* (Springer Science & Business Media 2010).

¹² Abdulaziz Al-Dukheil, 'Saudi Stock Market' (The Future Vision for the Saudi Economy, 2002).

capital markets were identified, namely:

a) a PhD thesis submitted by Awwad Saleh Awwad in 2000 under the title: 'Legal Regulation of the Saudi Stock Market: Evaluation, and Prospects for Reforms'¹³; b) a journal article written by Joseph Beach in 2005 under the title: 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets'¹⁴; and c) a journal article written by Gouda Bushra Ali Gouda in 2012 under the title: 'The Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market of 2003'¹⁵.

The topic of Awwad's doctoral study is the same as that of the current study in some aspects, but some findings and information are no longer relevant and up-to-date as the study was undertaken before the revision of the Saudi capital market regulatory framework in 2003. Nevertheless, there are not many studies investigating the development of the earlier regulatory framework, therefore, Awwad's study is still important from this perspective.

A particularly important contribution of Awwad's study is that it establishes correlations between doctrinal and non-doctrinal materials and contrasts Saudi doctrine against other doctrines. It must also be noted that Awwad derived research data from primary sources that other researchers could not get access to, namely, fieldwork and interviews with Saudi officials. Furthermore, despite focusing on the same topic, this study and Awwad's study address different dimensions of the topic, which is normal, given the temporal distance between the two studies.

The journal article written by Beach provides a direct overview of how the 2003 Capital Market Law came to be introduced, since the author took part in the drafting of this law. Through most of the article, Beach adopts a descriptive instead of an analytical approach to discuss the blueprints or source points associated with the law. Some of the information in the article may

¹³ Awwad Saleh Awwad, 'Legal Regulation of the Saudi Stock Market: Evaluation, and Prospects for Reforms' (University of Warwick 2000).

¹⁴ Joseph W Beach, 'The Saudi Arabian Capital Market Law: A Practical Study of the Creation of Law in Developing Markets' (2005) 41 *Stan J Int'l L* 307.

¹⁵ Bushra Ali Gouda, 'The Saudi Securities Law: Regulation of the Tadawul Stock Market, Issuers, and Securities Professionals under the Saudi Capital Market Law of 2003' (2012) 18 *Ann Surv Int'l & Comp L* 115.

have become irrelevant because the regulatory framework has been changed several times since the article was published in 2005.

As far as the current researcher is aware, the latest and most detailed secondary source on the Saudi capital market regulatory framework is the article written by Bushra Ali Gouda. However, since the author is a practicing attorney in New York, USA, the article is concerned mainly with describing and examining the black letter of the law and so it seems to be intended more for practitioners. The article does not comprehensively deal with the use of capital market institutions to achieve socio-economic aims, how those aims are promoted by the regulatory framework, or how systemic stability is maintained.

Due to the secondary materials it uses, the article does not mention the IOSCO standards¹⁶, the five-year plans developed by the Ministry of Economy and Planning (MEP) or the Capital Market Authority of Saudi Arabia (CMA) yearly reports. In fact, the article and the present study do not address the same dimensions of primary sources and highlight specific components of doctrine differently. To sum up, despite all being products of the legal discipline and having a wide scope, the three identified studies are incompatible with the present study due to dealing with different aspects or using different primary and secondary sources.

However, the efficiency of particular aspects of the regulatory framework of the Saudi capital market has been assessed by only a couple of studies, such as:

a) a PhD thesis titled 'An Evaluation of Investor Protection in Secondary Securities Markets: A Comparative Study of Regulatory Regimes in the United Kingdom and Saudi Arabia', submitted in 2012 by Sultan Alabdulkarim¹⁷; and b) a PhD thesis titled 'Corporate Governance: The Saudi Arabian Capital Market and International Standards', submitted in 2010 by Mohammed Alsanosi¹⁸.

¹⁶ This IOSCO sets out 38 Principles of securities regulation, which are based upon three Objectives of securities regulation. These are: protecting investors; ensuring that markets are fair, efficient and transparent; reducing systemic risk.

¹⁷ Sultan Alabdulkarim, 'An Evaluation of Investor Protection in Secondary Securities Markets' [2012].

¹⁸ Mohammed Takuk Alsanosi, 'Corporate Governance: The Saudi Arabian Capital Market and International Standards' (Thesis, University of Leicester 2011).

The above studies are useful because of their legal viewpoint and the use of methodological approach (i.e. empirical investigation) and primary and secondary sources similar to those used in the present study. However, the general scope of this study is only partially covered by these studies, which focus instead on other research aims.

1.4 Background

The legislation and regulations that govern the operation of securities market are there to do two things: to protect those who invest in securities from predatory or downright criminal exploitation, and to prevent institutional failure. If a securities market implodes that will adversely affect the financial stability of the state.¹⁹ This happened in 2006 in Saudi stock market.

The Saudi stock market was exposed to a big crash in February 2006 which continued until the end of 2006, which had a profound impact on investor and the economy.²⁰ The Saudi stock index prices lost 52% of their value by the end of 2006 in comparison to the end of 2005. As a result, Saudi people lost a lot of their money as many people tended to invest in stock market after the boom in 2003. This was caused by securities trading in an anarchic way in a market that still in its evolution process.²¹

Accordingly, The Saudi stock market crash of 2006 prompted this thesis into whether regulations of Saudi securities market aimed at regulating the above four issues to afford better protection to investor. Therefore, effective disclosure and transparency regulations are needed to afford proper protection to investor. In addition, market abuse, in which the absence of regulatory laws leads to the provision of the necessary motivation for the practice of market manipulation, insider trading and illegal practices of brokers, is also a growing concern.²²

¹⁹ George J Stigler, 'Public Regulation of the Securities Markets' (1964) 37 The Journal of Business P117.

²⁰ Baamir (n 1).

²¹ Bader Abdulaziz Alkhalidi, 'The Saudi Capital Market: The Crash of 2006 and Lessons to Be Learned' (2015) 8 International journal of business, economics and law 135.

²² Baamir (n 1).

Currently, stock market in Saudi Arabia is an important and timely topic as the Saudi government enters a major evolutionary process of economic expansion. A strong, domestic financial system should be appropriately maintained to ensure are country a cope with the risks associated with globalization. As noted by Many authors of modern applied economics studies, such as Cameron, Gurley and Shaw,²³ and more recently, Levine²⁴, confirm that a close relationship exists between the evolution of stock market and rates of economic growth. stock market generally supports economic growth and development through a number of their economic functions. Nevertheless, the absence of adequate financial sector policies and a developed financial system can produce disastrous outcomes, as illustrated by global financial crises. A strong domestic financial system should therefore be appropriately maintained to enable countries to cope with the risks associated with globalisation in general and the global integration of financial market in particular.²⁵

Moreover, Saudi stock market is an emerging market, so the legal framework that regulates the stock market is still considered to be underdeveloped, as is the institutional infrastructure in this market which is still in an evolutionary process. Thus, having efficient and effective regulations will reduce the market's risk by making it safer and stronger by increasing their ability to respond to financial markets' fluctuations and accelerated growth, on the other hand, a poorly regulated, or in practice unregulated, securities market has a markedly damaging effect on investor and the economy of the state.²⁶

Thus, Emerging market have the greatest need of robust and efficient securities regulations to ensure their economic growth.²⁷ Major economies, such as those in the United Kingdom and the United States, have legislation to ensure that investor are adequately protected. This legislation has evolved over the years in an effort to increase the level of protection. For

²³ John G Gurley and Edward S Shaw, 'Financial Aspects of Economic Development' (1955) 45 The American Economic Review P515.

²⁴ Ross Levine and others, 'Stock Market Development and Long-Run Growth' (1996) 10 World Bank Economic Review P323.

²⁵ Thomas Barnebeck Andersen and Finn Tarp, 'Financial Liberalization, Financial Development and Economic Growth in LDCs' (2003) 15 Journal of international development P189.

²⁶ Joseph E Stiglitz, 'The Role of the State in Financial Markets' (1993) 7 The World Bank Economic Review 19.

²⁷ M BIS, 'Financial Stability in Emerging Market Economies' [1997] Bank for International Settlements, Basle.

example, in the UK, the Financial Conduct Authority (FCA) has two main objectives. The first is a strategic objective to ensure that the qualified market function well.²⁸ Secondly, there are operational objectives to secure a suitable level of protection for investor, to protect and enhance the integrity of the UK financial schemes²⁹, and to encourage effective competition in the interest of consumers.³⁰ By comparison with the UK, Saudi is still at the early stages of its evolutionary process to improve investor protection.

Therefore, theoretical argument was raised that countries whose tend to enhance the growth of their securities market have implied laws that protects all investor especially small ones and present the investor with useful information. According to La Porta, Lopez de Silanes, Shleifer & Vishny who proved that there is a correlated relationship between the level of protection that a country provides to its small investor and its capital market strength³¹. it was also La Porta et al proven that the growth of security market protection is heavily relies on the nature of countries regulations. Coffee has found that the existence of securities protection regulations is valuable to investor.³² He also pointed out that investor who suffer from operating in a country that provides an environment with insufficient legal protection are able to overcome such a problem by listing their shares in an advanced legal protection environment.³³

1.5 The Importance of the Stock Market

The importance of capital market in economic development lies in their role as a mechanism for collecting private and public savings and directing these towards various investment channels. Capital market also represent a connection between sectors (i.e. savings) that have

²⁸ According to part 1A, section 1F of the Financial Services Act 2012.

²⁹ According to part 1A, section 1I of the Financial Services Act 2012.

³⁰ Financial Services Act 2012, pt 1A s 1B.

³¹ Ross Levine and Sara Zervos, 'Stock Markets, Banks, and Economic Growth' [1998] American economic review 537.

³² John C Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1998) 93 Nw UL Rev PP 641.

³³ *ibid.*

surplus resources and sectors that lack the liquidity to fund investments. This relationship, in turn, serves the objectives of development, regardless of the country at issue.³⁴

Many authors of modern applied economics studies, such as Gurley and Shaw³⁵, and more recently, Levine³⁶, confirm that a close relationship exists between the evolution of capital market and rates of economic growth. Capital market generally support economic growth and development through several their economic functions. Nevertheless, the absence of adequate financial sector policies and a developed financial system can produce disastrous outcomes, as illustrated by global financial crises. A strong domestic financial system should therefore be appropriately maintained to enable countries to cope with the risks associated with globalisation in general and the global integration of financial market in particular³⁷. Thus, this section will explore the importance of stock market firstly for Economic and for company and finally for investor.

Firstly: The importance of the stock market for economic can been seen over the past decade, global equity market has witnessed the most explosive growth and the emerging equity market have experienced an increase even more notable than developed countries' equity markets, taking on an ever-larger share of this global boom. For instance, overall global capitalization rose from US\$4.7 trillion to US\$15.2 and the emerging equity market share jumped from less than 4 to 13 percent in the same period. Since 1985, the value of shares traded in developing market has risen from less than three percent of the world's \$1.6 trillion total stock capitalization to 17 percent of the \$9.6 trillion total in 1994.³⁸ The global boom and the emerging markets' contribution to it have drawn the attention of both academics and policymakers. Consequently, many studies are now focusing on how to measure the benefits

³⁴ Asli Demirgüç-Kunt and Vojislav Maksimovic, 'Law, Finance, and Firm Growth' (1998) 53 The Journal of Finance P2107.

³⁵ Gurley and Shaw (n 22).

³⁶ Levine and others (n 23).

³⁷ John H Boyd and Bruce D Smith, 'The Evolution of Debt and Equity Market in Economic Development' (1998) 12 Economic Theory 519.

³⁸ Hamid Mohtadi and Sumit Agarwal, 'Stock Market Development and Economic Growth: Evidence from Developing Countries' [2001] On line] Available at: <http://www.uwm.edu/mohadi/PA-4-01.pdf>.

of globally-diversified portfolios, "while a large number of countries expound regulatory reforms to foster capital market development and attract foreign portfolio flows".³⁹

However, there are very few empirical studies showing that how importance the stock market to economic growth also, no single study exists in the developing countries. There is one study by Levine and Zervos that shows⁴⁰ a positive relationship between Stock market development and long-term economic growth,⁴¹ but their study "relies on a cross-sectional approach with well-known empirical limitations including the inability to sort country-specific effects".⁴²

In this context, the stock market appears to have not only the effects of the level, but also to assess the effects however, in this context there is an argument, on side believe that stock market support long-run growth⁴³. Greenwood and Smith⁴⁴ support this opinion by saying that "stock market lower the cost of mobilizing savings, facilitating investments into the most productive technologies".⁴⁵ Obstfeld proves that the stock market provides a vehicle for diversifying risk through internationally integrated stock market⁴⁶, whilst Bencivenga⁴⁷ and Levine⁴⁸ have claimed that stock market liquidity – the ability to trade equity simply – plays a key role in economic growth.⁴⁹

The second perspective throws into question the contribution of stock exchanges to long-term

³⁹ *ibid.*

⁴⁰ Levine and others (n 23).

⁴¹ Andreas Billmeier and Isabella Massa, 'What Drives Stock Market Development in Emerging Markets—institutions, Remittances, or Natural Resources?' (2009) 10 *Emerging Market Review* P23.

⁴² Mohtadi and Agarwal (n 37).

⁴³ Rojid Sawkut and others, 'Stock Market Development and Economic Growth in Developing Countries' [2010].

⁴⁴ Jeremy Greenwood and Bruce D Smith, 'Financial Market in Development, and the Development of Financial Markets' (1997) 21 *Journal of Economic dynamics and control* P145.

⁴⁵ Levine and others (n 23).

⁴⁶ Maurice Obstfeld, 'Risk-Taking, Global Diversification, and Growth' (National bureau of economic research (1992).

⁴⁷ Valerie R Bencivenga and others, 'Liquidity of Secondary Capital Markets: Allocative Efficiency and the Maturity Composition of the Capital Stock' (1996) 7 *Economic Theory* P19.

⁴⁸ Levine and others (n 23) P23.

⁴⁹ Mohtadi and Agarwal (n 37).

economic development. For instance, the function of stock exchanges in improving informational asymmetries has been addressed by Stiglitz, who contends that stock exchanges uncover data through price changes quickly.⁵⁰ However, questions have been raised about the contribution of liquidity to long-term growth. Demirguc-Kunt show that increased liquidity may limit growth through three channels⁵¹. To begin with, it may lessen saving rates through wage and substitution impacts. "Second, by reducing the uncertainty associated with investments and greater stock market liquidity may reduce saving rates because of the ambiguous effects of uncertainty on savings".⁵²

Gurley and Shaw⁵³ long ago advanced a particular view of the relationship between financial market and real activity, which is that financial market are a fundamental aspect of the process of economic growth. Their argument was that financial market could improve the borrower's financial capacity and the efficiency of trade, and that well-developed financial exchange can provide the necessary liquidity to investor for their projects.⁵⁴ "Much of the literature on the relationship between financial market and real output suffered a lack of evidence until the 1970s when studies by Goldsmith, Shaw and McKinnon found that development of financial market was significantly correlated with the level of per capita income"⁵⁵.

Moreover, Primary/ Secondary market: both the money market and the stock market consist of a primary market and secondary market; here it will briefly highlight the importance of each market for the economy. The primary market assists economic growth through its ability to move savings and financial surpluses of individuals and institutions from the circle of compactness to the circle of beneficial and worthwhile investment. It provides the necessary funds for productive work and development projects from various sources, especially from the private sector, the participation of which the market seeks to maximize because of its large

⁵⁰ Sanford J Grossman and Joseph E Stiglitz, 'On the Impossibility of Informationally Efficient Markets' (1980) 70 *The American economic review* P393.

⁵¹ Aslı Demirgüç-Kunt, *Developing Country Capital Structures and Emerging Stock market* (World Bank Publications 1992) vol P933.

⁵² Sawkut and others (n 42).

⁵³ Gurley and Shaw (n 22).

⁵⁴ Boyd and Smith (n 36). PP1,9.

⁵⁵ Guglielmo Maria Caporale and others, 'Stock Market Development and Economic Growth: The Causal Linkage' (2004) 29 *Journal of economic development* P33.

financial surpluses and the significant role, which it is expected to contribute to development.⁵⁶

When it comes to the secondary market, investor is starting to wonder about its activity in terms of market impact and role in the economy; does the intensity of trading operations serve economic development? Productive economic sectors gain no benefit as a result of this activity, it does not necessarily increase the size of national savings or increase investment operations in the stock (because trading in the secondary market does not represent any actual investment that adds to the economy), and it is not a new real investment. It is merely transition of ownership from one individual to another that does not help the national economy directly, though it is clear that the most important tasks of secondary market in securities are to provide liquidity for the IPOs of shares, to facilitate trading of these securities, and to be converted into cash quickly and easily whenever the bearer wishes to do so.⁵⁷

If investing in securities capable of being acted in a short time at competitive prices, it raises the value of this investment and thus raises the yield relative to these securities compared to other financial instruments. Therefore, the weakness of secondary market consequent lack of or low relative yield securities, and thus lead to a decline in demand and this includes the high costs of capital and reduces the incentives to invest in new projects.⁵⁸

This of course is not in the interest of the economy; hence the secondary market is one of the important factors in the growth of the national economy because it contributes to the allocation of savings available to it. The success of the secondary market and increased activity makes securities attractive to savers. This is reflected positively in the primary market where it leads to increased investor appetite and their interactions with the operations of the primary market, whether in new companies or to increase the capital of companies continuing to develop their production processes. It undoubtedly maximizes opportunities for establishment of new public joint-stock companies, which is sought by the stock market to help the national economy.⁵⁹

⁵⁶ Andriansyah Andriansyah and George Messinis, 'Equity Market and Economic Development: Does the Primary Market Matter?' (2014) 90 Economic Record P127.

⁵⁷ *ibid.*

⁵⁸ Caporale and others (n 54) P35.

⁵⁹ Electronic Bulls and Bears: U.S. Securities Market and Information Technology. (DIANE Publishing (1990) P6.

Finally, the importance of capital market in the process of economic development is its role as a mechanism for collecting private and public savings directed towards various investment channels Dailami and Aktin⁶⁰. Moreover, it represents a connection between the sectors (i.e., savings) that have surplus resources and the sectors that lack the liquidity to fund investments, which in turn serves the objectives of development no matter the specific country.⁶¹

It has been confirmed by studies⁶² of modern applied economics that there is a close relationship that links the evolution of capital market and rates of economic growth. In general it can be said that the capital market support the process of economic development and economic growth through a number of their economic functions, which can be summarized as follows:⁶³

Firstly: Increasing the rate of investment growth in the national economy: The stock market works to encourage savings investment in general and to encourage small investor to save in particular. Those who cannot establish investment projects for a number of reasons, such as small amounts of savings or lack of knowledge of the available and feasible investment opportunities, prefer to buy securities with their money. This increases the rate of investment growth and increase employment rates and thus increase the rate of economic growth.

Secondly: Transferring via the stock market financial resources from groups that have a surplus (savers) to groups that need this money (investors) to establish investment projects which are reflected in an increase in operating activity and an improvement in the standard of living in the community. Thirdly: Contributing to the financing of projects for economic and social development in the country where the stock market is providing the funds needed by the government for the establishment of investment projects. This is especially true for infrastructure projects, where government securities enable governments to increase their efficiency in the implementation of fiscal policy and monetary assessments. These tools are also a major means of financing the fiscal deficit and managing liquidity. In terms of financial

⁶⁰ Mansoor Dailami and Michael Atkin, *Stock market in Developing Countries: Key Issues and a Research Agenda* (World Bank Publications 1990).

⁶¹ Boubakari Ake, 'The Role of Stock Market Development in Economic Growth: Evidence from Some Euronext Countries' [2010].

⁶² Levine and others (n 23).

⁶³ Caporale and others (n 54).

markets, they give the investor the option of liquidating all or some assets easily and at an affordable price.

Fourthly: Representing an indirect supervisory authority on the efficiency of companies and projects that trading their securities in the market, thus providing a tool for evaluating companies and investment projects. Fifthly: Providing a range of financial instruments that create broader opportunities for the investor to choose in various areas of investment, which reduces the inefficiencies of individual savers having to research and choose investments that suit them.

Sixthly: Reducing rates of inflation in the national economy by attracting the savings of individuals and institutions, thus absorbing excess liquidity and directing those savings towards investment rather than consumption. Seventhly: Taking advantage of global financial and economic developments, since the stock market operates with increasing interdependence with the outside world. Finally: Providing a reliable daily indicator of investment conditions and trends, reflecting both the strength (or weakness) of the national economy and the level of performance of broader economic sectors and individual companies.

Secondly: the importance of the stock market for companies; an advantage of these companies is that they are characterized by the possession of legal personality separate from the personal owners of capital. They exercise the activities of producing, marketing, investing and financing under the name of the company, not on behalf of the partners. The personal independence of the company can continue the company, regardless of the continuing relationship with existing shareholders, so the exit of any shareholder of ownership in the capital does not mean the company stops. Another advantage is that the debt owed by the company for the benefit of others is not the responsibility of the shareholders⁶⁴.

Furthermore, the fragmentation of capital on a number of share can involve a large number of investor in capital financing, thus providing large amounts of capital that are not available in other types of markets. They all remain responsible for the company as much as if they owned shares only. The fragmentation of capital and limited liability for investor and the separation

⁶⁴ Borowski, A (2010). Financial Management. Germany: GRIN Verlag. PP3-5.

of capital ownership from management help in the trading of the company's shares in the open market, which provides liquidity to the shareholder who wishes it. Another important advantage involves where grants put its IPO. Thus, market tend to look at public companies as being managed in a more professional and transparent way (i.e., audits and the publication of periodic financial statements and performance data).⁶⁵

It also facilitates the ability of investor to use their shares as guarantees to get loans. Consequently, improved marketing helps the company's investor and reduces the company's problems. It also helps to meet the liquidity needs of investor who prefer to keep their wealth in the form of assets instead of in their interest in the company. Moreover, the financial situation of the company is improved, which is a direct result of the sale of the company's shares to the public. This strengthened financial position facilitates the search for loans to the company and helps in negotiating the terms of these loans.⁶⁶

However, “indicators of Saudi stock market have reflected the depth of the market and its financing, which creates an environment suitable for funding, and which total market capitalization at the end of 2010 attained US\$ 353.44 billion, arise of 10.86% in comparison with the end of previous year. The total value of shares traded for 2010 was US\$ 202.45 billion as against US\$ 337.07 billion for the previous year, a fall of 39.94%. The total number of transaction executed during the year 2010 reached 19.54 million compared to 36.46 million trades for the previous year, decreasing by 46.42%, while a total of 33.10 billion shares were traded in 2010 compared to 57.13 billion over the previous year, a fall of 42.22%”.⁶⁷

Finally: the importance of the stock market for investor, one of the most important factors is the ease of trading in the shares of these companies in the stock market. They represent a transfer of ownership of these operations from the hands of equity investor to other investor without affecting the continuity of the company's business or causing any confusion that occurs

⁶⁵ Bagley, E & Dauchy, C (2011). *The Entrepreneur's Guide to Business Law*. 4th ed. USA: Cengage Learning. P707-710.

⁶⁶ Andriansyah and Messinisa, G. (2013). *Equity market and economic development: Does the primary market matter?* Available: http://www.murdoch.edu.au/School-of-Management-and-Governance/_document/Australian-Conference-of-Economists/Equity-markets-and-economic-development.pdf. Last accessed 27th Dec 2013

⁶⁷ Capital Market Authority, ‘Annual Statistical Report - Saudi Stock Market’ (2006).

because of these transactions. It also ensures freedom and speed of trading in the shares of joint stock companies. The ease of the transfer of shares to liquidity needs may have shareholders, which tempts investor.⁶⁸ Moreover, shareholders' exposure to losses or profits is artificially high because of speculation in the stock market, to the detriment of small-scale shareholders.

Moreover, shareholders, especially small shareholders, can be involved in the conduct of the business of the company. However, the indifference of many of them to attend the meetings of the General Assembly, which convenes annually to discuss the company's business during the year, leads to limiting the decision-making to a few investor who own the majority of shares and who in most cases are in the management of the company. Through stock market, investor can implement investment decisions quickly compared with the private sector, which invests in companies or real estate, so it can buy or sell listed companies easily. In uncertain times, liquid investments provide an invaluable advantage.⁶⁹

Another important factor is that investing in stock market in an inflationary environment can protect investor from impairment by increasing corporate profits. By purchasing additional shares, investor become part owners of the companies in which they invest, which means the acquisition of interests in real estate, machinery and products owned by companies listed on the stock exchange. Even a small allocation of investment in the stock provides the advantages of diversification of risk in the sense that it follows the most important rule in investing: 'Do not put all your eggs in one basket'⁷⁰. However, investor can face huge losses if the value of shares drops dramatically. Many factors can impact the prices of shares, such as natural disasters, negative rumours, and profit downgrade, which can lead to a fall in share prices.⁷¹

1.6 Theoretical Framework for Securities Regulations

We might start with the view of a number of academics, of which an example is Ronald⁷²

⁶⁸ Paul Lyndon Davies, *Introduction to Company Law* (Oxford University Press 2010) PP20,23.

⁶⁹ Julian Velasco, 'The Fundamental Rights of the Shareholder' (2006) 40 UC Davis L Rev P407.

⁷⁰ Boyd and Smith (n 36).

⁷¹ *ibid.*

⁷² RH Coase, *The Problem of Social Cost*, *Journal of Law and Economics*, III, October, 1-44, 1960 (WE und OATES, Hrsg: *The Economics of the Environment* 1992).

(Nobel Prize Winner in Economics), who asked whether any regulatory action by governments is appropriate, or at least, at what kind of level. Governments should keep out of the securities markets. Any external interference can only have a distorting effect on their operation.⁷³

In that regard and as previously noted, this view makes the assumption that investor transacting in the securities market are informed and experienced parties. It is also part of the argument that underwriters, brokers, and issuers are anxious to preserve a reputation for fair and competent dealing, which they would see as essential for the success of their businesses. Investor in these market enter into contracts that are up-to-date and understood by all the parties involved so ordinary contracts and tort will be enough protection against any breaches of them. According to this view, investor only want to be informed where they scent false prospectuses or bogus deals.⁷⁴

A study by Stigler made a before and after comparison of the US stock market in relation to the setting up of the U. S. Securities and Exchange Commission (SEC) in 1933, and found that investor in common stocks post SEC in the 1950s did hardly better than they had in the 1920s, and no better at all if they only held the securities one or two years.⁷⁵

The "law matters" scholars who take the opposite stand, fall into two main schools of thought, having in common that the law in relation to contracts and torts is not precise or strong enough to protect the smaller investor from being cheated, but they have divergent opinions on what kind of regulatory regime should be imposed. The first school believes that such regulations should be concerned only to ensure that contracts entered into in securities market are standardized, making clear exactly what liabilities are being taken on and what responsibilities shouldered by each party, and providing enough information to protect the investor.⁷⁶ It is assumed that through standardization and clear guidelines that judges and the injured parties will be able easily to rule that there has, or has not, been a breach which will facilitate enforcement. This would be reducing both uncertainty as well as lower costs. In this view, the

⁷³ *ibid.*

⁷⁴ Rafael Porta and others, 'What Works in Securities Laws?' (2006) 61 *The Journal of Finance* P1.

⁷⁵ George J Stigler, 'The Theory of Economic Regulations' [1971] *The Bell journal of economics and management science* P3.

⁷⁶ John C Coffee Jr and others, 'Securities Regulations: Cases and Materials' [2015].

mechanism for private enforcement remains the most suitable method of imposing securities regulations.⁷⁷

The other school believes that private enforcement through the courts is not enough to protect the smaller and less powerful investor.⁷⁸ regulations should be made and enforced by a public enforcer. Those with this view take the line that the judges are unsuitable for this kind of enforcement as they "courts are under financed, unmotivated, unclear as to how the law applies, unfamiliar with economic issues, or even corrupt".⁷⁹ They also maintain that a public enforcer, it is easier to encourage a regulator compared with a judge, as regulator is committed to enforcing the regulations it itself has set up, whereas judge are harder to motivate because the nature of their independence and their post. Against this, highly-motivated regulators and, in some instances, judges, may be too keen to enforce through previously poorly-publicized or obscure requirements – inhibiting companies from listing for fear of being trapped in some unforeseen byway of the rules.⁸⁰

The Coase argument for little or no public regulations will not work in the Saudi securities market that investor, brokers, and other involved parties in Saudi market are nothing like as mature as the argument's supporters assume. Neither is reliance on private enforcement will not be valid. This is due to the fact that in general, investor and investor activism is largely inactive in all but a very few exceptional cases. The Saudi securities market needs a public enforcer to make and enforce regulations so that this market is seen as efficient, operated in an honest spirit, and stimulating investor confidence in it. Therefore, the need for regulations is noticeable, as evidenced by several financial crises and scandals, from which Saudi is not protected. Nevertheless, of the theories, the reality is that financial crises have occurred, people have suffered as a result, and this could have been avoided by having sound regulations in place. There is a greater development toward intervention in and regulations of the market.

It is worth to mention that there are three crucial elements of securities regulations: firstly, the

⁷⁷ A Mitchell Polinsky and Steven Shavell, 'The Economic Theory of Public Enforcement of Law' (National bureau of economic research 1999) P1049.

⁷⁸ Porta and others (n 73).

⁷⁹ Edward Glaeser and others, 'Coase versus the Coasians' (2001) 116 The Quarterly Journal of Economics P853.

⁸⁰ *ibid* P854.

legal framework itself, secondly, supervision thirdly, enforcement of related laws. Supervision and enforcement are tools used to ensure compliance with the legal framework. Compliance indicates to obedience to laws and regulations, whereas supervision intentions to identify non-compliance with laws and regulations, and enforcement aims to identify and punish non-compliance. finally, both supervision and enforcement obtain to encourage implementation of laws and regulations.⁸¹

One of the main feature of the regulatory is creating a supportive infrastructure for contract enforcement and dispute determination. This infrastructure has many features that collectively are known as the “rule of law”. Luis Rubio argues that there are three main features of the rule of law in financial markets.⁸² “First, it includes both political and legal guarantees of civil liberties and property rights. Second, the rule of law presumes an efficient judicial system that cuts transaction costs and limits predatory behavior. Third, it establishes legal security, meaning that under this rule of law citizens can plan their future courses of action and execute these plans in a context of well-known rules that will not be changed arbitrarily”.⁸³

Generally, the current financial theory of stock market growth outline two sets of elements affecting the growth of stock / financial markets: “macroeconomic elements” and “institutional elements”. However, institutional elements include variables that reflect the state of regulatory and supervisory institutions, such as legal frameworks etc.⁸⁴ A sufficient regulatory framework is critical to the growth of stock market. A strong and transparent legal framework needs to be developed for public issuers of securities, market brokers, settlement processes and transparency requirements and controls to prevent market abuse.

⁸¹ Kamal A El Wassal, ‘The Development of Stock market: In Search of a Theory’ (2013) 3 International Journal of Economics and Financial Issues P606.

⁸² Coffee Jr and others (n 75).

⁸³ Luis Rubio, ‘A Rule of Law Emerges in Mexico, Slowly’ (2001) 27 Wall Street Journal Eastern Edition PA19.

⁸⁴ Mr Amat Adarov and Mr Robert Tchaidze, Development of Financial Market in Central Europe: The Case of the CE4 Countries (11–101, International Monetary Fund 2011).

1.7 Protection of Investor from an Economic Perspective

Any proposals or suggestions for reforming anything must always be examined in order to avoid any unintended consequences. Is there any chance that the situation following the reform might be worse, in economic terms, than the one that held in the unreformed situation? As the aim of stock market regulations is to have a perfect capital market, this aspect deserves close scrutiny.

It is only when the price of securities is governed solely by supply and demand, with no investor or players having a privileged or artificially created superiority over others, where all have equal access to information and the process of buying and selling is transparent that a market can be called ‘efficient’, which is what regulations strives to achieve. Without the enforcement of full disclosure and transparency in operations, evidence from the past tells us the ordinary private investor, lacking the resources and the know-how of the institutional punters, will always end up being short-changed and taking losses.⁸⁵

According to Carvajal and Elliott that regulations of the stock market need to address asymmetries of information between issuers and investor, client and broker and between counterparties to transactions, in addition to settlement mechanisms that will prevent market disruption and promote investor confidence.⁸⁶ The key stone of regulating of stock market is to ensure that an information asymmetry between investor and the market is best reduced by a system of truthful disclosure, where Stock market investor rely on the availability of accurate information to make quick decisions.⁸⁷

Perhaps it should not, as many academics have done, make too much of the positive effects bequeathed by regulations enforced by market or governments. There are other voices arguing that investor protection has its downside too. Some will say that regulations – which they would describe as over-regulations, results in lower levels of corporate earnings – and that especially

⁸⁵Eugene F Fama, ‘Efficient Capital Markets: A Review of Theory and Empirical Work’ (1970) 25 The journal of Finance P383.

⁸⁶ Ana Carvajal and Jennifer A Elliott, Strengths and Weaknesses in Securities Market Regulations: A Global Analysis (2007–2259, International Monetary Fund 2007).

⁸⁷ Stijn Claessens and others, ‘Corporate Governance Reform Issues in the Brazilian Equity Markets’ [2000] Washington, DC, United States: World Bank Mimeographed document.

hits hard on the share values held by managers of successful businesses. This, it is maintained will inescapably lead to poor quality financial reporting. Daniel Verier predicts that excessive investor protection could result in companies preferring to borrow rather than raise capital in the market.⁸⁸

At least let us observe that regulations do not come cost-free and so market regulations must result in a balance between costs and benefits. Consequently, stock market should not be over-regulated in zones where free market forces should be predominant, as well as stock market should not be under-regulated where a normal regulatory framework should be support the market confidence.

In addition, upholders of traditional interactions between law and economics, hold that financial market should be regulated lightly and investor should be left to negotiate and enforce contracts. Those who endorse this view argue that courts are responsible for and capable of, enforcing these complex contracts. Not all economists agree, and have a good deal of research to dismiss the premises which underlie the view. Rafael La Porta, along with others, showed⁸⁹ that light regulations is not efficient and ought not to be practiced. States that have stringent and robustly-enforced securities regulations to protect investor, generally have better and more developed capital markets.⁹⁰

In this thesis the researcher gives three main reasons why comprehensive securities market regulations is absolutely necessary in Saudi. They are: The private contract hypothesis of securities transactions demands regulatory institutions and robust enforcement to function

⁸⁸Daniel Verder and others, Financial Capital Mobility and the Origins of Stock market (European University Institute 1999).

⁸⁹ "... the emphasis on legal rules and Regulations protecting outside investor stands in sharp contrast to the traditional law and economics perspective on financial contracting. According to that perspective, most Regulations of financial market are unnecessary because financial contracts take place between sophisticated issuers and sophisticated investors. On average, investor recognize a risk of expropriation, penalizing firms that fail to contractually disclose information about themselves and to contractually bind themselves to treat investors. well. Because entrepreneurs bear these costs when they issue securities, they have an incentive to bind themselves through contracts with investor to limit expropriation (Jensen and Meckling, 1976). As long as these contracts are enforced, financial market do not require Regulations (Stigler, 1964; Easterbrook and Fischel, 1991)."

⁹⁰La Porta and others (n 30).

efficiently, and this is not currently the case in the Saudi jurisdiction; The theory that private investor can enforce equitable contracts is based on an assumption that virtually all investor in Saudi market is sophisticated; this is simply not the case in the Saudi market; many investor lack the power and knowledge to engage in negotiated contracts with corporate and institutional investor; and there is tangible evidence that states with well-structured and robustly enforced securities regulations have uniformly enjoyed more efficient, more liquid, and less volatile market than their unregulated counterparts in other jurisdictions.⁹¹

Regulations that is effective in protecting investor from the kinds of fraud and swindling will make a major contribution to the growth of relatively new market such as Saudi stock market. Investor who are confident that anyone who attempts to perpetrate such expropriation or cheat them will be detected and punished will be comfortable investing, will increase their investments and consequently attract more companies to raise capital and have their securities publicly traded.⁹²

1.8 Research Methodology

In order to achieve the multi-objective purpose of this thesis, the appropriate method will be applied to the previously stated objectives. Thus, the thesis will adopt a combination of methods including doctrinal, theoretical, comparative, and contextual.

The doctrinal method used by the thesis will contain an analysis of the existing legislations, regulations and statutes related to the stock market. The primary focus will be on Capital Market Law 2003 and its associated regulations, specifically Listing rules, Corporate Governance, Authorised Persons and Market Conduct regulations, as well as additional, relevant Saudi laws and regulations affecting the protection of the investor in stock market.

Furthermore, this thesis will apply the theoretical method to examine the questions and notions; ‘Is regulations of a stock market necessary?’ and ‘How should the stock market be regulated?’ Protection of investor from an economic perspective, as well as the importance of the stock market, will be discussed as Chapter One described.

⁹¹ Porta and others (n 73).

⁹² Leora F Klapper and Inessa Love, ‘Corporate Governance, Investor Protection, and Performance in Emerging Markets’ (2004) 10 Journal of corporate Finance P703.

In addition, the methodology in some parts of the thesis can be considered contextual, since the thesis examines the law within its social and economic context. Chapter Five, for example, examines the socio-environments of Saudi Arabia of insider trading regulations. The aim is therefore to assess whether the future regulatory efforts that CAM may undertake are likely to succeed from the perspective of investor protection.

It is necessary to use the descriptive method in some parts of the thesis, especially Chapter Two, as to enhance the effectiveness of existing rules to secure a suitable level of protection for investor. Overall, the thesis uses the critical analysis method in its remaining sections dealing with four controversial issues previously outlined, concerning the protection of investor in stock market.

Also, it is crucial to use the comparative method in this thesis (particularly throughout Chapters Five and Six). In legal studies, as Mantysaari argued that it is broadly known that the use of a comparative study plays a fundamental role in developing and improving the reformation of laws and legislations in any country.⁹³ Also, according to Zweigert and Kotz, comparative law not only aims to criticize existing rules but also to make law in general more efficient and indicative of the best ways to enhance the effectiveness of existing rules, as well as formulating entirely new ones.⁹⁴

As part of the process of reforming and improving law in a given jurisdiction, it must be advisable to make comparisons between legislations one state to another; a view shared globally by legislators themselves. The purpose of comparisons is not to condemn or criticize what is in place but, to take a concept from business activities, to adopt and adapt best practice; hence making existing laws and regulations more effective and accessing the best of legislation and regulations from outside. As Hill concluded in his study, a comparative method can support to "demonstrate the extent to which the form and substance of any legal system are not 'natural', but result from the implementation of moral and political values".⁹⁵

⁹³Petri Mäntysaari, *Comparative Corporate Governance: Investor as a Rule-Maker* (Springer Science & Business Media 2005).

⁹⁴ Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Clarendon Press ; Oxford University Press 1998) P34.

⁹⁵ Jonathan Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 *Oxford J Legal Stud* P101.

The UK legal system and stock market regime are appropriate reference points for comparative analysis due to their series of features.

First of all, The CMA is the regulatory authority active in Saudi Arabia, whereas the Financial Conduct Authority (FCA) is the regulatory authority in the UK. The need to deal with the problems of market manipulation, insider trading and inadequate disclosure, which have affected the UK for more than 50 years, is the reason why the FCA is preferred in this country.

Other reason for selecting stock market regulations of uk, is that the many cases of market manipulation, insider trading and inadequate disclosure undertaken in the UK is another reason for choosing this country as an assessment standard. Furthermore, the UK system is part of a wider regulatory framework because it includes the EU Market Abuse Directive (MAD). Additionally, the FCA has considerable deterrence power as it enjoys extensive authority in regulation enforcement.

Additionally, reformation of the stock market regulations in Saudi Arabia is based on the UK stock market regulations as they are better developed, and they are selected as a model or benchmark to reform Saudi stock market regulations. Moreover, rather than trying to address limitations in the UK stock market regulations, the aim is to benefit from their advanced development and to learn from them to deal with the weak aspects of the Saudi stock market regulations.

Moreover, When the Thatcher government came to power, it sought to reform the public sector, through privatizations as she described in her memoirs, Lady Thatcher saw privatization as “fundamental to improving Britain’s economic performance”⁹⁶. public services in particular, due to inadequacies. The Saudi government is facing a similar position, as Saudi Arabia have already, and is likely to continue in the near future, to privatize sensitive areas such as Saudi Arabian Oil Company (Aramco), as the Saudi government adopted the so-called Saudi Vision 2030⁹⁷.

⁹⁶ Stanford Jim, ‘Privatization If Necessary, but Not Necessarily Privatization?’ (2008) 54 Review of Income and Wealth 116.

⁹⁷ For further information about Saudi Vision 2030 visit: Saudi Vision, ‘A Developed Digital Infrastructure’ (vision 2030.gov.sa, April 2016) < <http://vision2030.gov.sa/en> > accessed 20th November 2018.

The UK stock market regulations is selected to be the model as its law is not one civil code but a common law, which is supported by legislation as well as precedent. This gives the legal system its flexibility, practicality and, most notably, predictability. Thus, the English legal system can be easily adapted to commercial requirements and transforming conditions and to technological innovations.

Another reason for choosing the stock market regulations of UK, as their regulations are examined to determine what limitations such systems have. The use of comprehensive security regulations and the appointment of special authorities in charge with financial market monitoring are the basis for their similarities to those of the Saudi system. Also, the present study will assess how applicable and relevant these frameworks are in the Saudi setting based on investigation of how limitations are addressed by the UK authorities.

Furthermore, In the specific case of stock market regulations, this thesis will compare the current KSA legal structure with that of UK, both those that would be described as developed, and those that are described as still finding their way to that degree of sophistication. Where relevant and necessary it will also address several legal jurisdictions with regard to economic aspects. The intention is to benefit from the UK's advanced development and to draw useful lessons from it to remedy weaknesses in Saudi regulations). Yet, the springboard for this comparison is, the UK since it has long-established capital markets and developed legal systems.

This thesis does not aim to be a comprehensive comparative study, but will present examples to illustrate the issues under discussion. Most of the chapters in the thesis will focus on a comparative analysis between KSA and the UK, taking into account various perspectives. It should be pointed out that there are, of course, inherent difficulties in comparing two legal systems in two different jurisdictions, since they are shaped by different customs and attitudes. Nevertheless, the aim of this comparative study is to identify strengths in the UK Stock market law that could be transferred to Saudi stock market regulations. Accordingly, this study seeks to look at various ways of effecting legal reform within the remit of these regulations.

As the thesis is a doctrinal study, it should be pointed out that this thesis will not only discuss stock market regulations, but will also explore some rules in different regulations, such as Saudi

and UK company law. In this study I will review case law, stock market regulations, and circulars and governmental decisions in the relevant area. In addition, this thesis will be carried out using both primary and secondary materials, such as legislation, judgments, literature, reports and opinions. In addition to this, this thesis will be carried out using both primary and secondary materials, such as legislation, judgments, literature, reports and opinions. A diverse range of electronic databases, including the LexisNexis database, will be consulted to ensure access to a wide range of contemporary and topical journals. The Internet will also be used, to allow access to important websites. Also, all other available and relevant sources will be used; these will include legal textbooks, journals (Westlaw, Lexis, Oxford and Cambridge Journals), case reports, legislative documents, international treaties on financing law, and other legal sources as necessary.

Subsequently, a combination of these methods is deemed the most appropriate approach with which to accomplish the objectives of the thesis. As has been claimed, showing a critical study without a foundation in analytical data would lead to unjustified outcomes, whereas showing an analytical study without a critique is useless. It should be pointed out that, secondary sources on the structure of regulations of the Saudi Arabian capital markets are scarce, which is unfortunate because the information within secondary sources is generally wider and goes deeper than can be had from primary sources. Secondary sources are useful to the researcher because they may draw attention to valuable but not necessarily obvious primary sources. They are also useful in throwing light on the background and reasons that created the primary sources. They also offer analysis of the primary sources and the different ways in which primary data can be processed.

1.9 Research Scope and Limitations

This thesis does not aim to be a comprehensive comparative study, but will present examples to illustrate the issues under discussion.

- This study's conclusions and generalizations are only applicable to Saudi Arabia and cannot be extrapolated and applied to countries with different investment environment, cultural norms and social composition.
- In Saudi Arabia cases are not published or catalogued, so there is no ready access to judicial decisions and this presents problems for the researcher, so the researcher had to go

some cases personal. It appears possible that cases may be published in the future, but this initiative is still in its infancy.

- Unfortunately there is little readily available information from secondary sources on the structure of the regulations which shape Saudi Arabia's capital market. This is regrettable, since secondary sources usually provide fuller and broader-ranging information than primary sources.
- It should be pointed out that there are, of course, inherent difficulties in comparing two legal systems in two different jurisdictions, since they are shaped by different customs and attitudes.

1.10 Research Contribution

The results of this research have thrown up a number of findings which contributions to the current body of knowledge in the field:

- To the researcher best knowledge, this is the first study to have investigated the measures which have been put in place to regulate the Saudi stock market, within the general context of investor protection under Saudi stock market regulations and re-establish investors' confidence in its market.
- This thesis' findings will enhance the body of legal knowledge in Saudi Arabia, particularly in especially in understanding the role of laws and regulations of Saudi stock market. It is significant that the analysis offered of the legal structures and of the regulations which apply to the capital market has theoretical implications for deliberations which are taking place in other academic fields. The findings of this thesis are intended to provide useful material for Saudi Capital Market Law (2003) reforms in the future. In addition, they can also be used as an instrument for reforming the Saudi stock market and shaping its growth, so that investor confidence rises and expands.
- There is little available literature on this topic in the region as a whole, and particular in Saudi Arabia itself. This thesis sets out to narrow the research gap and provide a legal viewpoint on how stock market regulations can have a positive impact on Saudi Arabia's stock market, and drive its development from an investor protection perspective.

- The Saudi stock market is gradually becoming more regulated, and this thesis focuses on regulations of Saudi stock market which exist or are being introduced, and pinpoints hurdles to their successful execution and application. Highlighting the problems in this area will assist policymakers and practitioners to draw up effective stock market regulations and improve current practice. This will, in turn, tackle pressing hurdles to transparency and investor confidence, such as market brokerage and manipulation, insider trading and issues surrounding disclosure. As a means of increasing the investment climate and international competitiveness and to ensure the development of Saudi stock market and restored investors' confidence in it.
- This study will assist both the government and the regulators to evaluate whether the market reforms they have introduced have met their aims. In addition, those who invest in the stock market need to be reassured about its efficiency, its stability and the effectiveness of the measures taken to protect investor and to inspire confidence in the stock market.
- Now that the Saudi stock market has opened to foreign investor, the latter may find it helpful when deciding whether or not to invest in the emerging stock market such Saudi stock market. Therefore. This thesis' findings will encourage Saudi regulatory authorities to attract foreign investment by have a well-developed legal framework that would ensure the minimal protection for such investments.

1.11 Research Outline

Chapter 1: This chapter reviewed the theoretical framework for securities regulations along with the thesis objectives and aims; Also, it presented the importance of the capital market for Economic, companies and investor and protection of investor from an economic perspective. Moreover, this chapter concludes with the Methodology, as well as any difficulties or challenges it may face.

Chapter 2: This chapter aims to present a historical review of the development stages; it also sheds light on the recent Saudi Stock Market crash by providing a description of the problem it. Moreover, this chapter concludes with overview of the current legal and judicial systems in Saudi with respect to the regulatory structure of the Saudi stock market. The focus is on exploring the legal regime that governs the stock market.

Chapter 3: the aims of this chapter is to assess the pattern of the disclosure rules in Saudi Arabia and financial reporting requirements also and periodic reporting requirements. Until recently there was very little concern about this issue. This chapter will, therefore, examine the current system of disclosure in Saudi Arabia, assessing whether they are adequate for their intended purpose. The researcher shall question whether, in light of the limitations of the current approach, a new set of rules is necessary to facilitate the release of information needed by investor.

Chapter 4: This chapter explores the overall picture of insider trading in order to analyze insider trading regulations in Saudi Arabia, and briefly, those in the UK, in order to assess the effectiveness of current Saudi laws for preventing insider trading and mitigating crime as well as their level of complexity. Here it will review and analyze the concept of insider trading in light of its intricacies, difficulties, confusions and shortfalls.

Chapter 5: This chapter defines market manipulation, elucidates its common forms and examines the effectiveness of current laws in preventing these forms. moreover, is to discover how well the law covers the most common forms of market manipulation as defined in the chapter. also, the chapter examines the current system of controlling market manipulation in Saudi Arabia to assess whether it is adequate for the intended purpose.

Chapter 6: This chapter discusses the legal implications of brokerage firms as represented by brokers' commitments and rights, which arose after the implementation of the market and the financial brokers' agreement and to examine the legal aspects of the broker's role as the backbone of any securities market, to achieve the greatest degree of protection for investor and to inspire confidence in the financial market. This includes reviewing the many submissions regarding unsuitable recommendations; the objective of which is to add weight to the recently designed law and thus support the Saudi court in its application of the new procedures and methods. As well as their suitability with the standards of disclosure, efficiency and transparency required in financial markets.

Chapter 7: provides the conclusion and recommendations that Kingdom policymakers could undertake in order to enhance the protection of investor in Saudi stock market.

Chapter 2: The Historical and Legal Framework of Saudi Stock Market

2.1 Introduction

As mentioned in the previous chapter, the development of an appropriate legal and regulatory framework is important to protect investor against market abuse and the lack of information symmetry among market participants, as well as to enhance investor confidence in the market. In the past decades, most developed countries have attached growing importance to the development of stock market and have focused on creating a legal and institutional environment conducive to domestic and foreign investments alike. The emphasis is the result of a growing awareness of the important role that these market play in the process of economic development.⁹⁸

Are there opportunities to take advantage of the 2006 Saudi stock crisis? Or is avoiding the drawbacks the best we can do? 11 years have passed since the Great Depression resulting from the 2006 stock market crash in which the economy lost more than 2 trillion riyals that could have been invested in development sectors. Saudis lost confidence in the capital market, while a significant proportion of families and individuals were pushed close to the poverty line, leading many in the community to seek bank loans. The value lost by listed companies is disastrous. There were no survivors, with only the company "Greer" retaining the same level of its stock over the period. Other negative effects will be mentioned in Section II.

The general market collapse of 2006 revealed the low level of structural, operational, and organisational characteristics of the Saudi stock market. The market failed to detect the impending crisis before it occurred, and then failed to adequately manage and deal with the crisis leading to one of the largest economic disasters in the country's history. This chapter aims to present a historical review of the development stages of the structural, operational, and regulatory characteristics of the Saudi Stock Market. Moreover, the aim of this chapter is to

⁹⁸ Stanford Jim, 'Privatization If Necessary, but Not Necessarily Privatization?' (2008) 54 Review of Income and Wealth 116.

analyze the regulations that govern the Saudi stock market, and ascertain whether they can aid the development of a quality regulatory framework.

The approach complements research on the relationship between investor protection and rules improvement. It also looks at problems relating to the recent Saudi Stock Market crash because it is considered an important historic event in the history of Saudi Arabia as well as the Calendar and can be seen as one of the most influential events in encouraging and stimulating the development of the stock market. The government has recently come under pressure to liberalise the securities market, including taking steps to counter insider trading and market manipulation by augmenting disclosure requirements. The government seeks to design a modern securities structure supported by a clear system of market rules.

2.2 History of the stock market

Financial market has existed since humans began to invest their savings until they reached the stage of projects that need financing beyond the capacity of their savings and therefore require large-scale investment. This prompted individual to use their savings to engage in profitable projects that would contribute to their savings, raise their level of income, and thus improve their standard of living. The idea of financial market is based on Adam Smith's⁹⁹ theory, which says that the division of work depends largely on the size of the market. Where there is a close relationship between the size of the market and the volume of production, this relationship is reflected in financial development and per capita income.¹⁰⁰

The development of capital market historically has been associated with the economic and industrial development experienced by most countries of the world, especially capitalist countries. The increase in the number of shareholding companies and the enthusiasm of governments to borrow led to a strong movement to handle financial instruments, which led to the emergence of stock exchanges.¹⁰¹

⁹⁹ Adam Smith: (5 June 1723 OS (16 June 1723 NS) – 17 July 1790) was a Scottish moral philosopher and a pioneer of political economy.

¹⁰⁰ Bela Balassa, *The Theory of Economic Integration* (Routledge Revivals) (Routledge 2013) P105.

¹⁰¹ TMHMA Accounting T, 'Nternational Stock Exchanges' (2008)P3.

Initially, instruments were traded on the side of the road in major countries, such as France, England, and America. Deals were then settled in private buildings, which later became known as stock market. At the beginning, it has to return to the idea of pluralism cash, which led to the birth of a new profession—currency exchange.¹⁰² In 527 BC, the rulers of ancient Greece ordered cashiers to switch the currencies of visitors to their cities. This profession developed rapidly in Greece and then spread throughout the Roman Empire.¹⁰³

In the first years after BC, this profession entered a dormant stage, with the exception of the Arab region. The profession then began to be practiced again and spread to northern Italy. Roman legislators decided at that time to establish a large number of laws and regulations relating to the operations of monetary deposits and currency exchange.¹⁰⁴

The profession was practiced in the republics of Italy, such as Genoa, Venice, and Florence because of their trade with the East, in which the international economy gained a prominent place. In Italy, capital began to accumulate, which necessitated the re-emergence of the profession of exchange. The title of persons working in that profession means bankers in English. At the beginning of the fourteenth century, the Belgian city of Bruges occupied the first position with respect to the cash market. During that period, members of the six large families that worked in the area of exchange usually met at the home of the president in order to study the process of buying and selling goods. They then wrote insurance policies and established procedures for everything related to the sale and purchase of money.¹⁰⁵

The word “bourse” dates back to the fifth century AD, originating in the name of the Vander Bourse family, which owned a hotel. Traders from Florence came to the Belgian city of Bruges to meet at the hotel, which was also frequented by traders from all regions. Because many traders did not take their goods with them, agreements were made in the form of contracts that

¹⁰² Sandra Choron and Harry Choron, *Money: Everything You Never Knew About Your Favorite Thing to Find, Save, Spend & Covet* (Chronicle Books 2011) P129.

¹⁰³ Investing, ‘Stock Market’ (2014).

¹⁰⁴ *ibid.*

¹⁰⁵ *The Annalist: A Magazine of Finance, Commerce and Economics* (New York Times Company 1940) P334.

replaced the goods by future obligations based on mutual trust between the transacting parties.¹⁰⁶

Hence, the Bourse designates the place where traders and dealers met to conclude deals and contracts. Of course, before that date, traders had met in other places that were not called bourses. For example, the Pharaohs in Egypt allowed traders to display their goods and price them in marketplace where all the merchants met and deals were made. The first building to house a Stock market was known by that name: in 1460, the stock market was built in Onfrs, Belgium. Subsequently, many stock exchanges emerged in Europe. The first organized exchange of values took place in Lyon, France. In 1549 and 1563, stock market was established at Toulouse and Paris, respectively, and the Exchange Bordeaux was opened eight years later. The stock market of Rome was established in 1566, followed by stock market in Amsterdam, the Netherlands in 1608, and Vienna in 1762.¹⁰⁷

The London Stock market emerged in 1773, which was organically associated with the early emergence of British capital. The New York Stock market was established in 1792, and it is now considered the most important exchange of values in the world because of the daily volume of exchanges.¹⁰⁸

In the Arab world, the first Stock market was established in 1883 in the city of Alexandria. Seven years later, the Cairo stock market emerged. In the first half of the last century, stock exchanges have emerged in other Arab countries, such as such as Lebanon, Morocco, Tunisia, Jordan, and Sudan. In particular, the establishment of market for securities has affected relations with European countries. However, the Gulf States were not known in the capital market until financial resources increased, which started in 1973 with the massive correction in oil prices.¹⁰⁹ Before the emergence of stock exchanges, if a person wanted to sell and buy a bond or share in some investment, it was necessary to announce his/her or desire by a simple means of advertising or to spread the news via friends in order to find a customer. However,

¹⁰⁶ Gilbert Durieux and others, French Financial Market (Woodhead Publishing 1995) P54.

¹⁰⁷ Accounting T (n 98).

¹⁰⁸ Rik W Hafer and Scott E Hein, The Stock Market (Greenwood Publishing Group 2007) PP10,13.

¹⁰⁹ Ranald C Michie, The Global Securities Market: A History (Oxford University Press 2006) PP15,20.

this changed completely after the establishment of stock exchanges, at which all requests for sales and purchases to determine prices and announce to all.¹¹⁰

2.2.1 History of The Saudi Stock Market

Notwithstanding its comparatively short history, the growth of the Saudi stock market has been extraordinary. In less than 15 years, the Saudi stock market changed from an underdeveloped market into the biggest market in the Arabic-speaking world. This section documents the development of the Saudi Stock market, examining the three formative stages in its growth. The analysis of the market growth provides a foundation for systematically evaluating the current situation and prospects for reforms.

2.2.1.1 The Preliminary Stage (1935 - 1982)

For a period between the years 1935 and 1982, the Saudi government and the associated regulatory bodies failed to expand its capital market. At the time, the stock market in the country couldn't keep up with international competition and was in urgent need of investment and positive change. It was relatively immature and quite basic. However, attempts to make improvements were largely unsuccessful and there are a number of probable explanations for this. The first reason for the lack of development is the state of the economy in Saudi Arabia. It was in its infancy and, even though it was evolving and growing stronger, it was still a young economy, in need of experience and maturity. For this reason, it was more important for the Saudi government to improve living standards for its citizens. It was more concerned with building up a skilled workforce, for example, and expanding its infrastructure. While this direction of focus was practical and logical, it meant that the stock market fell behind, particularly in comparison with the rest of the world.¹¹¹

The second reason is that the stock market just wasn't a primary target for financing for the government. In fact, it took a long time for its expansion to become a key government agenda. Saudi Arabia grew to be a very wealthy country, in a short space of time, due to its abundance of natural resources. As the exclusive owner of multiple massive oil reserves, the government was able to provide businesses with lots of different ways to access interest free lending.

¹¹⁰ *ibid.*

¹¹¹ Donald M Moliver and Paul J Abbondante, *The Economy of Saudi Arabia* (Praeger Publishers 1980).

Ultimately, the stock market lost out on this attention and the chance for growth during this period.¹¹²

There are a number of studies which investigate this phase of the Saudi stock market and, in particular, its sluggish growth during the almost fifty-year period described. They have highlighted some key characteristics of the timeframe, which might help to explain why the stock market took so long to develop. For instance, Shook and Abdeen believe that it was because the stock market lacked order and foundation. It had no clear regulatory structure to guide it. Instead, there were four legal bodies (state operated) with the responsibility of directing the market. They are the Saudi Arabian Monetary Agency, the Ministry of Finance and National Economy, and the Ministry of Commerce.¹¹³

It is certainly likely that, without an efficient legal structure or any clear regulatory guidelines, the stock market would have found it hard to grow and expand. It didn't help that shares were routinely traded by unapproved and uncertified brokers. This contributed to the general sense of chaos within the market and less secure share ownership. Also, the founding and/or board members owned a much bigger portion of the company shares. These individuals had lot more control and they could influence trades in a way which suited their personal interests. Needless to say, not many of their actions benefited low level stakeholders or the general public. The problem is that most Saudis didn't have a complete working knowledge of the stock market. They couldn't always trade securely or recognize when they were being exploited.¹¹⁴ They weren't taught how to identify valuable trading opportunities or how to utilize basic technical evaluations. This uneven distribution of power had the effect of unbalancing the market.¹¹⁵

On top of the vulnerabilities already discussed, there was a distinct lack of investment opportunity in Saudi Arabia. The dearth of investment choices meant that the general public didn't take much of an interest in the market. Up until 1975, there were a mere 14 joint stock enterprises operating within the Saudi stock market. The limited amount of investment channels and pathways to domestic financial market began to encourage more speculative

¹¹² *ibid.*

¹¹³ Adnan M Abdeen and others, *Saudi Financial System* (Wiley 1984).

¹¹⁴ A Al-Dukheil, 'The Future Vision for the Saudi Economy' (Conference of Ministry of Planning, 2002).

¹¹⁵ Abdeen and others (n 110).

activities.¹¹⁶

By 1983, the amount of listed enterprises had climbed to 38. This is largely due to a period of intense oil investment and exploration during the seventies. It was further supported by a comprehensive ‘Saudisation’ plan from the government. It aimed to privatize more businesses, substantially boost foreign investment and increase the number of foreign commercial banks.¹¹⁷

2.2.1.2 The Established Stage (1984 - 2003)

During the seventies, the government decided that it urgently needed to expand and develop its economy. For many years, the top export had been oil and it was responsible for a huge amount of the national income. The plan stretched across five years and it aimed to make the Saudi economy much more varied and independent. In fact, there were a number of ‘Five Year’ programs. The first began in 1970 and the objective was to strengthen the infrastructure of Saudi Arabia. The focus was on improving standards of living and building up a skilled workforce. With the release of the third Five Year plan, the government began incentivizing investment in the national economy, so that private companies would take an. In 1986, it established a more robust regulatory system for private-public ventures, which it hoped would support foreign investment.¹¹⁸

These economic plans were the beginning of a new phase for the Saudi economy. This was when it entered what is known as the ‘established’ stage of maturity. The first step was the complete modernization and organization of the stock market, so that it could compete with those of other countries. The second step was a three-member partnership of legal bodies, which was, in 1983, appointed with the monitoring and leadership of the market.¹¹⁹

This three-member partnership was made up of the Saudi Arabian Monetary Agency (SAMA) the Ministry of Finance and National Economy, and the Ministry of Commerce. Each body

¹¹⁶ *ibid.*

¹¹⁷ *ibid.*

¹¹⁸ Tim Niblock and Monica Malik, *The Political Economy of Saudi Arabia* (Routledge 2007).

¹¹⁹ Tim Niblock, *State, Society and Economy in Saudi Arabia* (RLE Saudi Arabia) (Routledge 2015) vol 6.

was appointed with a specific duty. For instance, SAMA had the job of supervising the daily actions of the stock market and making sure that it operated efficiently. The Ministry of Finance and National Economy was tasked with managing its expansion and development. And, finally, the Ministry of Commerce dealt with the initial public offering and regulations of the joint stock enterprises.¹²⁰

During the second stage of the market (between 1983 and 2003), far reaching changes were seen right across the stock market. They influenced almost every organizational and regulatory aspect; from the overall market structure to trading policies, and daily operations.¹²¹ The 1997 SAMA review describe the following improvements and developments:¹²²

The number of commercial banks permitted to carry out intermediation services was capped at twelve. The upper limit for service charges was set at 1%. In 1984, these twelve commercial banks established a principal ‘Saudi Share Registration Company.’ The association had been converted into a fully automated resource by 1989, but for some time, it handled the settlement of share purchases and the registration of limited enterprises. Also in 1989, the National Centre for Financial and Economic Information created a general index of shares. It was designed to evaluate and monitor the efficiency of the market. It operated via a points based system. The base value was 100 points, which were adjusted according to a value weighted system. In 1995, a second stock market index was created – the Consulting Centre for Finance and Investment Index.

In 1990, SAMA introduced a digital shares data system. It marked the beginning of the ‘floorless’ market in Saudi Arabia. This is because it allowed lots of investor, spread across many geographical locations, to continue trading on the market, all at the same time. Soon after the millennium, the original title of the digital shares data system (the ESIS) was changed to the Tadawul All Share Index (or TASI). It operates a little differently as well, because the newly named resource added a T + 0 (same day transaction guarantee). For the first time, digital trading became a major part of the Saudi stock market. In fact, it dominated the TASI, as it is built to handle large amounts of internet activity. The updated index also incorporated a much

¹²⁰ Al-Dukheil (n 111).

¹²¹ Ramady (n 11).

¹²² Al-Dukheil (n 111).

more sophisticated deposit structure and more efficient trading guidelines. Plus, it provides a greater number of financial options, including debentures, investment enterprise units, corporate bonds, and treasury bonds too.

The operational abilities of the stock market were similarly improved and expanded. This was achieved with the incorporation of more detailed financial data and timelier ('real time') updates. This resource was made available on the official digital platforms and helped traders to make secure, efficient transactions. Finally, in 1997, foreign investor was permitted to take part in the Saudi stock exchange. This was forbidden during the initial stage of its development.¹²³

Due to the scope and reach of these changes, the Saudi stock market began to experience substantial growth and improvement, particularly in comparison with its earlier phases. New technologies were introduced and they further refined stock market activities and made it easier to trade. In addition to this, clearer regulations meant that trading was safer and more secure. On the other hand, there was still no independent body responsible for its supervision and direction.¹²⁴

This lack of a unified regulatory body is an important detail, because the existing three-member partnership was not as efficient as hoped. There is, in large part, because the three entities didn't interact very efficiently. They were rarely unified and didn't always work together to achieve unified objectives. It should also be noted that the degree of activity and contribution to the stock market (in terms of investment) was actually quite low, particularly in terms of turnover. In 2002, for example, the level of investment was only around 28.9%. At this point, there were 68 joint stock enterprises operating within the market, but this is still quite a small amount and it could be one of the reasons why the stock market continued to perform sluggishly. The Saudi government (and only a handful of wealthy families) owned most of the shares in these listed enterprises. This meant that there was only a minimal amount of shares left available for free stock market activity. This, undoubtedly, slowed the growth of the Saudi market.¹²⁵

¹²³ Saudi Stock Exchange (Tadawul), 'Annual Statistical Report' (2007).

¹²⁴ Al-Dukheil (n 111).

¹²⁵ Niblock and Malik (n 115). N

For quite some time, enterprises weren't obliged to share financial data. In fact, there was a distinct lack of interest in issues like liability and transparency. The joint stock listed enterprises were asked to reveal their profits once per year, but there were no punishments for refusing to do this. Ultimately, the general 'fairness' of the market just wasn't a top priority at the time. The maturity and rapid development of the stock market seemed much more important to the government.¹²⁶

There was no such thing as 'voluntary disclosure' at this time, so Saudi enterprises did not have to share data in the interests of transparency or for any other reason. Therefore, businesses revealed only the very minimum of information, particularly when it came to their profits. As a result, insider trading was rife and high level traders were able to influence the market in ways which best suited their interests. This added to the general imbalances within the market and made it even more pressing for the government to introduce stricter controls. In addition, there was a dearth of independent professional trading brokers, because only twelve commercial banks were permitted to carry out intermediary services.¹²⁷

2.2.1.3 The Modernized Phase (2003 - date)

Fortunately, the government acknowledged the vulnerabilities and limitations of the market and its early development agendas. After a time, its Five Year plans focused on strengthening and improving the stock market, on a broader level. There has, since, been a greater emphasis on transparency, clearer regulations, and the construction of a rigorously controlled market structure which can compete with those in other countries. In 2003, the Royal Decree # M / 30 established the 'Capital Market Law.' It marked the beginning of another new phase of growth for the Saudi stock market.¹²⁸

This stage of development is often referred to as the 'Modernized' phase. In 2003, under the authority of the new Capital Market Law, the Capital Market Authority was introduced. It is an independent state established body, with the responsibility of supervising the stock market.

¹²⁶ *ibid.*

¹²⁷ *ibid.*

¹²⁸ The Capital Market Law, pursuant to Royal Decree No. (M/30) dated 4/6/1424H - 31/7/2003, was issued to create a transparent, fair and regulated market that keeps pace with the current developments in other international financial markets.

Ultimately, the Capital Market Authority has become the most dominant supervisory organization within the capital market (CMA Yearly Report, 2009). It is the enforcing body of the CML. It takes its findings directly to the Prime Minister of Saudi Arabia.¹²⁹

In the years since its creation, the primary purpose and function of the CMA continues to be the improvement and monitoring of the Saudi stock market, as a whole. This accounts for the maintenance, application, and supervision of the Saudi privatization scheme, which has been integrated with various different diversification plans and agendas. The overarching aim of these agendas is still to strengthen the economy of the country and identify more sources of profit and capital.

During the third ‘Modernization’ stage of the stock market and its evolution, the following changes have been made: In 2007, the Saudi Stock market (SSE) was constructed. It has the duty of supervising and handling financial transactions, via investment instruments based in Saudi Arabia. It also has a capital foundation of SR1200 million, which is controlled by a Public Investment Fund. The SSE used to be referred to as ‘Tadawal’ and it once operated as an independent joint stock enterprise. Originally, it took care of standardizing and finalizing financial transactions, in a way which guaranteed a fair, honest outcome. According to the CMA Yearly Report, this was an important objective for the Saudi government and the Capital Market Authority. The creation of the SSE essentially separated the operational elements of the market, by making them distinct and divided from its regulatory aspects.¹³⁰

Several new supervisory regulations were also introduced by the CMA. They were designed to ensure the fair distribution of data and the honesty of quality disclosers. It is keen to safeguard the frank, open disclosure of data for all investor working with listed enterprises. To achieve this, enterprises with initial public offerings need to be willing to provide accurate data about the issuers of securities. The CMA applies a number of key trade limitations relating to enterprise executives and board members, if they want to contribute to the stock market. To prevent insider trading from misbalancing the market, it also discloses data about the block holders of enterprises who own over 5% of their shares.¹³¹

¹²⁹ Capital Market Authority, ‘About Capital Market Authority’ (2014).

¹³⁰ Ibid.

¹³¹ Gulf base, ‘History of the Saudi Stock Market’ (2013). Available:

In 2001, a resolution of securities conflicts was established by the CMA, in early 2011. This was designed to bring an end to disruptive trading challenges and clashes. In 2008, there was a reshaping of the industrial elements of the stock market. The aim was to create a system which was substantially more efficient than the earlier definitions. The venture was directed by the CMA and it categorized all fifteen of the existing industrial sectors into a series of clear, concise classifications.

According to the CMA Yearly Report, these new classifications formed the basis for updates to the Tadawul All Share Index. The objective of these changes was to provide a clearer representation of the stock market as a whole, so that investor could make informed, rational trading decisions. The following measures were introduced as a way to further expand and diversify the Saudi market: In 2006, the CMA divided all share values from SR50 to SR10. In 2007, GCC citizens were awarded investor approval, as a way to boost the level of activity within the stock market.¹³² In 2008, foreign investor and citizens were permitted to contribute to and make transactions within the Saudi market.¹³³

In 2009, the CMA helped a total of 110 independent professional broker to finalize transactions. After this point, banks were forbidden from carrying out intermediary services, unless appointed by the government. In 2009, for the first time, corporate and SUKUK bonds were incorporated in the form of trading securities. The measures are part of an attempt to diversify and improve the stock market, via the financial engineering of new tradable investment options across the whole trading system. They have boosted the value of corporate and SUKUK bonds, which was calculated at SR 280 billion in 2010. These new measures have also substantially increased the scope and depth of the market, overall.

Throughout the most recent phase of the stock market (the Modernization stage), the CMA has incorporated lots of new investment opportunities. It has also expanded the financial market by forcing listed enterprises to accept more liability and for their activities and any consequences of these actions. To summarize, over many years, the Saudi government has

<http://www.gulfbase.com/gcc/index/1?t=3>. Last accessed 3th MAR 2014.

¹³² Saudi Stock Exchange (Tadawul) (n 120).

¹³³ Capital Market Authority (n 66).

progressively and consistently improved its stock market, until it has been left with strong, robust trading system which can rival that of more mature economies. In 2009, the CMA delivered over one million copies of an investment awareness brochure. It contained a wealth of medial lessons and guidelines on the reporting of accounting disclosures for listed enterprises. This is just one example of the government's new commitment to stock market education. The regulatory body also sponsored a university learning course, as a way to help students understand the market and the history of the Saudi economy.¹³⁴

2.2.2 History of the London Stock Market

In London, the stock market began in 1698 in the Cafe Jonathan. The owner (Jonathan Castaing) decided to display lists of goods and stocks for those interested under the name of The Course of the Exchange and Other Things. In 1725, many of the brokers working in the City of London an had been customers of Cafe Jonathan decided to expand, and in 1773, they changed the name of the cafe to The Stock Exchange.¹³⁵

The announcement was made by John Taylor, who stated, "We sell and buy lottery tickets new, ration cards marine, bonds and the East India Company, and other public bonds". As stocks grew and new companies joined to raise capital, the royal court also raised some monies. This is the earliest evidence of organized trading in marketable securities in London.¹³⁶ In 1669, a regulated stock market was born when Gresham's Royal Exchange building was rebuilt and re-established after it was destroyed in the great fire of London. This was a step towards an advanced model of the stock market. The Royal Exchange consisted of brokers, merchants and merchandise. However, it had problems with unlicensed brokers, which were resolved in 1697 when Parliament established an act that imposed severe punishments, both physical and financial, on those brokering without a license.¹³⁷

¹³⁴ The Capital Market Authority, 'Saudi Arabia Annual Report' (2007).

¹³⁵ Edward Peter Stringham, 'The Emergence of the London Stock Exchange as a Self-Policing Club' [2002].

¹³⁶ Ranald C Michie, *The London Stock Exchange: A History* (OUP Oxford 1999).

¹³⁷ CF Smith, 'The Early History of the London Stock Exchange' (1929) 19 *The American Economic Review* P206.

In 1720, the London Stock Exchange's first case of a collapse of financial market in occurred when a wave of speculation led to an "explosion" of the first known bubble market—the South Sea Bubble!.¹³⁸ "In 1802 the Exchange moved into a new building in Capel Court. And in 1812, the first codified rulebook was created. The exchange had recovered by the 1820s, bolstered by the growth of the railways, canals, mining and insurance industries (there were, however, problems with stags and dividend payments). Regional stock exchanges were formed across the UK. Bonds (or gilt-edged securities) also began to be traded".¹³⁹

In 1836, the first regional exchanges opened in Manchester and Liverpool 1836. In 1845, speculative fever—this time "Railway mania"—swept the country. In March 1854, the Stock market was rebuilt.¹⁴⁰ "In 1876 a new Deed of Settlement for the Stock market came into force". In 1914, the stock exchanges were hit hard by the outbreak of the First World War, which lead to closing the Stock market from the end of July until the New Year; thus, street business started again. In 1923, The Exchange received its own Coat of Arms with the motto *Dictum Meum Pactum* (My Word is My Bond).¹⁴¹ The US. stock market crash on October 29 had a major influence in UK, As in December of 1929, a scandal on the London Stock Exchange, containing a great fraud by a promoter, caused a drop in the London Stock Exchange.¹⁴²

On the first day of September 1939, the Exchange closed and two days later, the beginning of World War II was announced after the declaration of war was signed. The Exchange's doors then reopened on September 7. In 1945, The Exchange closed for only one day because of damage caused by a V2 rocket; trading then continued in the building's basement.¹⁴³ In 1972, Queen Elizabeth opened the new building of the Stock Exchange, which is 321 feet tall, has 26

¹³⁸ David S Landes and others, *The Invention of Enterprise: Entrepreneurship from Ancient Mesopotamia to Modern Times* (Princeton University Press 2012) PP113,115.

¹³⁹ Accounting T (n 98).

¹⁴⁰ Sheill

a Nyasha and NM Odhiambo, 'Stock Market Development In The United Kingdom: Prospects And Challenges' (2013) 12 *The International Business & Economics Research Journal* (Online) P725.

¹⁴¹ *ibid.*

¹⁴² Marty Gitlin, *The 1929 Stock Market Crash* (ABDO 2008) P82.

¹⁴³ *ibid.*

stores with Council and Administration at the top, and has a trading floor of 23,000 sq. ft.¹⁴⁴ "In 1973 the first female members were admitted to the market. The 11 British and Irish regional exchanges amalgamated with the London exchange".¹⁴⁵

In 1991, the trading name became "The London Stock Exchange" because the governing Council of the Exchange switched to a Board of Directors drawn from the Exchange's executive, customer, and user base. In 1995, the London Stock market launched the Alternative Investment Market (AIM) to allow developing companies to expand into international markets.¹⁴⁶ In 1997, with the launch of the electronic trading system of the Stock market service (SETS), stocks began trading with higher liquidity. This electronic system depends on the prices of orders. When the purchase price and the selling price match, the command is executed automatically.¹⁴⁷

"In 2000 the London Stock market transferred its role as UK Listing Authority with HM Treasury to the Financial Services Authority (FSA). Investor voted to become a public limited company: London Stock market plc".¹⁴⁸ In 2003, the London Stock market launched EDX London, a new international equity derivatives business in partnership with the OM Group," The Exchange also acquired Proquote Limited, a new generation supplier of real-time market data and trading systems".¹⁴⁹

In July 2004, Queen Elizabeth II opened a new building to house the London Stock Exchange, which moved from Threadneedle Street to Paternoster Square (EC4) close to St Paul's Cathedral.¹⁵⁰ "On the 23rd June 2007, the LSE agreed to take over the Milan-based Borsa Italiana for 1.6 bn. euros (£1.1 bn.; \$2 bn.) The Group operates out of the Stock Exchange's headquarters in Paternoster Square".¹⁵¹ The London Stock market is the most important in Europe and one of the largest stock exchanges in the world. It lists more than 3,000 listed

¹⁴⁴ *ibid.*

¹⁴⁵ Accounting T (n 98).

¹⁴⁶ *ibid.*

¹⁴⁷ Hakman A Wan, *Electronic Financial Services: Technology and Management* (Elsevier 2006) P187.

¹⁴⁸ Michie (n 133).

¹⁴⁹ *ibid.*

¹⁵⁰ Accounting T (n 79).

¹⁵¹ *ibid.*

companies. Exchanges are more prevalent at the international level, which includes 350 companies from 50 different countries. London Stock market Securities are electronic; however, different systems are used for different types of trading stock.¹⁵²

2.3 Crash of The Saudi Stock Market

Prior to 2006, the Saudi capital market had not endured a substantial crash. The capital market swiftly and unexpectedly grew a considerable percentage starting in 2003 and, in comparison to 2518.1 at the end of 2002, the “TASI” (Tadawul All Share Index) concluded in 2003 at 4437.6 points. It is stated that the significant increase in the capital market was generated by a number of contributing factors which included: a sense of improved assurance in the market, the expansion of the domestic economy, elevation in income for a series of corporations, the continually decreasing rate of return on deposits and, lastly, a high quantity of new market depositors¹⁵³. The TASI had enlarged by 84% to 8206.23 points by the conclusion of 2004 and, by the conclusion of 2005, the TASI had grew by a considerable 103.7% to 16,712.64 points¹⁵⁴.

To look beyond the figures, amid the years 2002¹⁵⁵ to 2003,¹⁵⁶ the market capitalization of issued shares amplified exceedingly fast from US\$75 billion to US\$157 billion and, similarly between the years 2004¹⁵⁷ to the end of 2005,¹⁵⁸ the figure rose from US\$306 billion to US\$650. Ultimately, on 25/02/2006, the TASI registered the highest point in its history which was 20,634.86.¹⁵⁹ At the end of 2005, SAMA issued new regulations intended to govern banks’ consumer finance agreements, which were enacted beginning in 2006. Consumer loans had grown between 2002 and 2005 by more than 370 percent, increasing from 38.4 billion riyals towards the beginning of 2002 to about 180.9 billion riyals by the end of 2005. At the same time, the number of stock market traders rose to about 2.6 million.¹⁶⁰

¹⁵²ibid.

¹⁵³ Saudi Arabian Monetary Agency, ‘Annual Report’ (2004) P140.

¹⁵⁴ Saudi Arabian Monetary Agency, ‘Annual Report’ (2005)P137.

¹⁵⁵ Saudi Arabian Monetary Agency, ‘Annual Report’ (2003)P146.

¹⁵⁶ Saudi Arabian Monetary Agency (n 150).

¹⁵⁷ ibid.

¹⁵⁸ (n 151).

¹⁵⁹ Saudi Stock Exchange (Tadawul) (n 120).

¹⁶⁰ ibid.

The considerable escalation in demand as a result of high quantities of extra investor in the stock market, either via banks with numerous forms of portfolios or directly, is the principle cause of the intense and unrelenting expansion.¹⁶¹ It is recorded that, at one period in time, over 50% of Saudi adults had invested into the stock market. However, it is important to acknowledge that, regrettably, a high proportion of these investor had liquidated their assets or taken out loans in order to finance their stock purchases.

Basically, in the year 2005, over 75% of consumer loans were for the purpose of something besides long-lasting goods, real estate or lines of credit. From these figures, it is justifiable to propose that a high percentage of the investor believed it was an unmissable opening in the capital market as it was a period where the market was experiencing continual and extreme expansion. The notion of investing money which investor did not actually have, became a common and almost attractive risk to a large quantity of people as they were witnessing such a surge in the financial market¹⁶².

According to a Saudi expert that a series of additional contributing factors were at play during this period. As a consequence of foreign and external unpredictability becoming a significant fear for investor following 9/11, a considerable quantity of capital began returning to Saudi from overseas. Subsequently, as there were no attractive additional investment options at this period in Saudi, a high percentage of the capital was invested straight into the stock market. However, the trading of shares was, on the whole, majorly unsupervised, banks delivered simple credit and physical facilities for the investor and, further, there was a significant and noticeable level of both legal and illegal speculation in the shares of a number of corporations.¹⁶³

Eventually, however, in February 2006 the dreams of many were shattered as “CMA” (Capital Market Authority) made the choice that the daily stock price fluctuation limit of listed companies was lowered to 5%. As a direct consequence of the decisions implemented by “CMA”, the TASI began to intensely and substantially drop towards the end of February 2006 and, almost instantly, approximately 13000 points were lost. The initial 3 weeks following

¹⁶¹ A Al-Twajry, ‘Saudi Stock Market Historical View and Crisis Effect: Graphical and Statistical Analysis’ (2007) 5 Journal of Human Science 1.

¹⁶² Niblock and Malik (n 115).

¹⁶³ Alkhaldi (n 20).

25/11/2006, TASI diminished by 25% to 20,634.86. However, following this, it looked as if the TASI became constant for numerous weeks as it maintained just higher than 15000¹⁶⁴.

However, while it was widely believed that the TASI had levelled, it then dramatically dropped again during a period of 3 weeks to approximately 10000 points. Throughout these 2 months, the TASI had reduced by a staggering 50%¹⁶⁵. At the conclusion of 2006, the TASI was recorded at 7,933.29 and, therefore, had diminished by 52.53% in comparison to 2005¹⁶⁶. Essentially, the figures reveal that TASI had reduced by approximately 65% from the largest recorded period where it reached 20,634.86 points in 2006. Additionally, dropping 49.72% from the year 2005, the market capitalization plummeted to US\$326.9 billion by the conclusion of 2006. Throughout the time of extensive growth in the market, more than 4 million Saudis had invested money into the Saudi stock market. A high proportion of the depositors were considerably inexperienced and naïve to this field and, notably, a large percentage were also retired, widowed or individuals with low incomes who believed, by liquidating all their financial savings and additional assets, they would receive momentous revenues.¹⁶⁷

Unsurprisingly, losing this amount of money in the stock market was a momentous loss to these individuals and, as a result, there were substantial ramifications felt throughout the Saudi economy.¹⁶⁸ What made this situation even more problematic was, instead of forming informed and educated decisions from taking advice from financial experts regarding the general and long-term forecast for Saudi's economy, these individuals made financial decisions based on the information given from their friends, work colleagues, family and the Saudi media.¹⁶⁹

As a result of the 2006 stock market crash, the economy lost more than 2 trillion riyals that

¹⁶⁴ Capital Market Authority, "the Board of the Capital Market Authority Resolution Number 1-141-2006, dated 24/01/1427 H (Feb. 23, 2006). On March 27th, 2006, the Capital Market Authority issued a decision to return the daily stock price fluctuation limit of listed companies back to 10% starting April 1st, 2006, because the risks associated with market prices correction have decreased. Capital Market Authority, the Board of the Capital Market Authority Resolution Number 3-154-2006, dated 27/02/1427 H (Mar. 27, 2006)".

¹⁶⁵ Al-Twaijry (n 158).

¹⁶⁶ Saudi Stock Exchange 'Tadawul' (n 2).

¹⁶⁷ *ibid.*

¹⁶⁸ Sami Al-Nwaisir, 'Saudi Stock Market Needs to Be Reformed - A R a B N E W S-' (2012).

¹⁶⁹ *ibid.*

could have been invested in development sectors. Saudis lost confidence in the capital market, and the losses pushed a significant proportion of families and individuals close to the poverty line, thereby forcing community members to seek bank loans. This problem disrupted individual development and the overall progress of the Saudi community. It also resulted in the collapse of the stock market as the withdrawal of millions of families reduced the levels of savings and investments.¹⁷⁰

Moreover, the pricing-related losses incurred by companies listed in the market reached a record proportion of up to 97 percent in 2006. During the last ten months of that year, the local stock market experienced one of the most difficult stages of its development. This stage saw repercussions similar to the Great Depression in that the market had been growing at an unprecedented rate for more than two decades. Overall, the index reached a yearly cumulative average growth rate that exceeded 719 percent from the beginning of 2003 to the pre-collapse period up to 25 February 2006.¹⁷¹

Determining why the stock bubble burst in 2006 necessitates first understanding how the bubble formed. The occurrence of the bubble can be explained through an analogy of a vehicle that is driven on the wrong lane. At the end of the lane, this vehicle is instructed to stop by a traffic officer, who asks the driver to return to the starting point and drive on the right lane. The driver is imposed a fine for the violation, an expensive outcome from the reckless violation of traffic rules. Similarly, imprudent or legally unsound investment decisions resulted in expensive losses. Investment ‘offenses’ came with an upper limit of more than five million portfolios (the price of the offenses) as compensation for owners. Such compensation highlights the importance of adherence to laws, regulations and legislation.

Although providing a single encompassing explanation for the occurrence and explosion of the stock market bubble is difficult, three reasons can, in combination, account for the aforementioned events. The theories demonstrate that the collapse of the Saudi stock market was caused by directly and indirectly related factors, which centre on four points: poor disclosure and transparency, market manipulation and insider trading along with market brokers.

¹⁷⁰ Capital Market Authority (n 66).

¹⁷¹ *ibid.*

While it must be acknowledged that idealistic and improbable hopes were large factors which generated such high levels of investment, it is also realistic to suggest that specific elements of the market may have added to constructing an idyllic image of the stock market between the years of 2004 and 2005. Prices rose artificially as a number of affluent investor were actually buying and selling stock between themselves which formed a false impression of big margins and avid interchanging in the market. Further, it should be acknowledged that there were elements not relating to the economy which added to diminishing prices.¹⁷²

In some specific situations, inside information were a contributing factor, however, in a high proportion of the scenarios, Smaller investor based their financial decisions on artificial profit margins. Further, minor or less experienced investor may have carefully examined and observed the trends within the market, but made the catastrophic mistake of presuming that these figures would continually grow and, therefore, they made what they believed were educated decisions and bought shares for prices which were already overblown. Commonly, rather than banks giving investor's realistic and levelled financial advice, they were too easily admitting credit to already financially stretched customers.¹⁷³

Unfortunately, yet unavoidably, the financial crash effected working class families most substantially. The devastation was anything from people becoming unemployed, begging for money or even being imprisoned as a consequence of being unable to pay the debts they owed. Huge proportions of the Saudi population had invested their whole life's worth of financial savings during this period and, consequently, the backlash after the crash was devastating.¹⁷⁴ People had simply not predicted a financial crash was imminent and, therefore, it was a severe shock for many to live through such financial change and uncertainty. Large proportions of people became ill, developed mental conditions or it was actually recorded that some individuals had died as a result of the crash and accompanying factors.¹⁷⁵

Furthermore, the repercussions of the crash were not limited to Saudi and the effects spread over to additional "GCC" countries (Gulf Cooperation Council). As a consequence of such a

¹⁷² Niblock and Malik (n 115).

¹⁷³ *ibid.*

¹⁷⁴ *ibid.*

¹⁷⁵ *ibid.*

major crash, investor across these countries became dubious regarding how fair the market was and, consequently, many made the executive decision of keeping investment and trading with Saudi Arabia to an absolute minimum¹⁷⁶.

As a direct result of the financial crash in 2006, it is probable that the Saudi stock market would be viewed in a different light in comparison to other stock market across the globe. As a consequence of the speculation and artificial spiral, it was evident that a company's performance levels were almost entirely detached from the share prices. It was actually recorded that some of the most unsuccessful corporations during 2005 and 2006 were among some of the largest values on the Saudi capital market¹⁷⁷. However, it must be acknowledged that simultaneously, a high proportion of large speculators bought and retailed the shares both as groups and individuals and, therefore, the price progressively grew as a result of the quantities of trading. Because of the lack of oversight and penalties, a high proportion of this illegal activity continued to occur even following the financial crash in 2006. Eventually in 2007, the CMA decided they must interfere with this activity and postponed trading and exchange among corporations whose financial losses surpassed their assets by 75%.¹⁷⁸

Furthermore, there were additional contributing elements which would have added at work that artificially increased prices. Primarily, an increase in domestic liquidity was still continuing and, therefore, prices were growing to an irrational height irrespective of what the listed company's financial statements would read. Essentially, it was concluded that a percentage of companies were capable of utilizing their financial reserves in order to cleverly mask the fact that they were functioning at a substantial loss. Secondly, as a result of CMA being fearful of probable adverse results that would be generated when hard-hitting consequences were implemented against manipulators in the market, the abusive practices continued to happen.¹⁷⁹ A likely reason for the CMA having considerable doubts regarding the action they could take

¹⁷⁶ S Hertog, 'Financial Market in GCC Countries: Recent Crises and Structural Weaknesses' [2012] Norwegian Peacebuilding Resource Centre P8.

¹⁷⁷ Abdulsabor Masari, *The Legal Regulations of the Corporate Governance* (Maktabt Alganon Oa Alagtsad 2012).

¹⁷⁸ Abdulrahman Alsultan, 'New Bubble is Forming in the Saudi Stock Market', *Al Eqtisadiyah Newspaper* (2006) <http://www.aleqt.com/2006/07/03/article_5702.html> last accessed 23 April 2015.

¹⁷⁹ Masari (n 174).

is that they were only newly founded in 2004 and, therefore, were inexperienced.¹⁸⁰

Despite the comprehensiveness of the CMA's measures, predicting the usefulness of previous decisions to limit or eliminate speculation is difficult to accomplish. Effective restriction or elimination, in turn, depends on transparency and fairness, which are the first pillars of success in any investment environment. In this regard, financial market laws clearly indicate that regulations focus on certain important aspects. To illustrate, I refer to two stipulations in the first law on the financial market, reported in the second quarter by the CMA: Article¹⁸¹ 5(a), items 4 and 5. Item 4 mandates the protection of citizens and investor in securities from unfair or improper practices, such as fraud, deceit or manipulation. Item 5 indicates that the CMA shall work to achieve justice, efficiency and transparency in securities transactions. Second, item (a) of Article¹⁸² 49 in Chapter 8 stipulates provisions for fraud and trading based on inside information. Specifically, the Act prohibits violation of the provisions of the Act and the intentional formulation of untruthful or misleading impressions regarding the market or the price/value of securities for the purpose of creating such impressions to encourage investor to buy, sell or subscribe to certain securities or to forgo such investment or refrain from exercising the rights granted by the securities investment.

The stipulations above reflect emphasis on crucial principles, including those related to dealers and protecting them from factors that affect decision making and progress in the investment process. The stipulations for such protection include guaranteeing justice and transparency in transactions, although these regulations require application, review and modification for suitability to specific market conditions. Despite the existence of the aforementioned provisions. However, inappropriate or unethical practices persist, thereby considerably influencing investor behaviour. Some behaviours are subtle and may be difficult to address. Examples are speculator recommendations that encourage people to either buy or sell certain shares. The most prominent example of the systematic manipulation of return on equity is the

¹⁸⁰ Mohammad Al-Aqeel and Nasser Spear, *Private Information Trading in Emerging Markets: Evidence from GCC Security Market* (2006).

¹⁸¹ Article 5 of Saudi capital Market Law (2003) .

¹⁸² *ibid.*

case of Borouge Insurance,¹⁸³ in which the manipulation caused fluctuations in share price; in a period of seven months, share price ranged from 19 riyals to 258 riyals per share. Despite the business losses incurred by the company, the reduction of shareholder equity by more than 20 percent within three years and the subsequent reduction in share price, Borouge Insurance has not been investigated or charged for suspicious transactions.¹⁸⁴

The failure to exhaustively police investment transactions generated a huge demand for trading, even if high prices do not reflect good performance of subsidiaries. Other recommendations on addressing the undeclared shares of some companies have been posted by some financial institutions on official sites and other media. Such active participation in the regulations of transactions gives rise to questions that the CMA has yet to answer. Some of these questions are detailed as follows. Do these recommendations, regardless of whether they are accurate, influence the behaviour and performance of investor in the market, as well as the shares owned by parent companies in their investment portfolios? These recommendations constitute a violation of Article 49¹⁸⁵ given that they urge investor to buy or sell.

However, aside from the factors which caused this, it was recorded that as a consequence to the CMA's reluctance to press charges, the behaviors continued to conduct illegal activity. While this activity stems back to as early as the year 2000, speculation and counter-speculation continued unabated. The main objective of these speculators was to purchase as many overblown shares as they possibly could and, this way, they could take full advantage of profit margins. Alongside the naïve and inexperienced first time investor who invested money for unrealistic returns, the investor were the core reason why the artificial idyllic capital market was constructed.¹⁸⁶

There are also additional causes which added to the 2006 financial crash in Saudi. One of them was the lack of transparency and disclosure by listed companies, banks, and some governmental agencies that were associated to the stock market. Several listed companies failed to disclose their financial statements. This behaviour continually progressed and the

¹⁸³ Borouge: Saudi Pearl Insurance Company is a Bahraini Insurance Company, established in Bahrain and is engaged in an offshore insurance business in Kingdom of Saudi Arabia.

¹⁸⁴ '164 Companies Are Listed in the Saudi Stock Market (Tadawul)' [2014] Middle East Journal.

¹⁸⁵ Article 49 Capital Market Law.

¹⁸⁶ Al-Aqeel and Spear (n 177).

government failed to intervene or enforce some kind of regulations regarding insider trading, manipulating prices, and making false statements. As there was no successful procedure applied to challenge or even slow down the development of these rumours, there failed to be a system which detected and prosecuted this criminal activity, partially because some investor had authority and relationships that allowed them access to material inside information. they continually expanded and grew during the years 2005 and 2006.¹⁸⁷

The investor utilised the inside information they could view in order to work either individually or as groups to illegally take risks in the stock market. Additionally, considerable inflation was generated in the Saudi stock market as a result of the high levels of liquidity with few listed companies. However, an ethical factor which must be carefully addressed is that, instead of limiting lending policies and providing individuals with realistic advice, Saudi banks extending their lending amounts and, consequently, the market was overran with liquidity. The causes of these insider trading and market manipulation.¹⁸⁸ The absence of disclosure and transparency encouraged recommendations for addressing these issues and caused problems related to inside information. The question is whether transparency and disclosure problems are caused by lack of control or legislative enforcement. The absence of transparency meant that the media coverage of Saudi Arabia was key to the dissemination of information in the stock market, driving many of the shareholding companies to disseminate necessary information to investor.¹⁸⁹

¹⁸⁷ Alkhaldi (n 20).

¹⁸⁸ Aggarwal and Wu conducted a statistical analysis of New York stock market manipulation cases between 1990 and 2001; they totalled 142 cases. Mei, Wu, and Zhou (2004) studied cases of manipulation of the same market between 1980 and 2002; they totalled 159 cases, and their results were similar to those of Aggarwal and Wu. I thus conclude the following: Most manipulation is of small stocks because of the ease of control and the low level of disclosure. Most of the issues based on the manipulation of trading were during Tricked, and mostly rumours, whether in collusion with newspaper columnists, marketers of new shares, or through the Internet. the Return on manipulation be greater, if the share price is highly volatile, and that because of the lack of information necessary to estimate the value of the stock with greater accuracy. Insider traders play a major role in manipulation, including company executives, brokers, issuers of securities, major shareholders, and market-makers. Manipulation strategies are based on the use of many portfolios with different names, but run by a single person or group of traders. See Rajesh K Aggarwal and Guojun Wu, 'Stock Market Manipulations' (2006) 79 *The Journal of Business* 1915. Also, See Carl E Walter and Fraser JT Howie, *Privatizing China: The Stock market and Their Role in Corporate Reform* (Wiley 2003).

¹⁸⁹ Alkhaldi (n 20).

This development enabled some investment and financial companies to exploit the media in promoting their shares, either directly or indirectly through financial analysts and technicians who appear on satellite television or write for local newspapers. Media reports and talks focused on the positive attributes and ignored the negative qualities of these companies. This practice, in turn, resulted in the distortion of information and facilitated immoral exploitation (moral hazard) by traders, who contributed to the large losses incurred from the lack of official information. In the April 2012 issue of the *Journal of Finance*, Solomon confirms that media coverage highlights the positive attributes but disregards the negative characteristics of companies, thereby resulting in increased share prices before results announcement. Studies on the influence of corporate investor relations (IR) and media coverage of investors' expectations indicate that companies work on behalf of their client to encourage high media coverage and the dissemination of positive news to raise the expectations of investor in the absence of market information.¹⁹⁰

Concerned authorities in developed countries limit exaggerated increases in stock value, whereas the Saudi market has no system in place for regulating twofold increases in company shares. The registered shares of some companies, including small companies such as Bisha,¹⁹¹ announced an exaggerated stock price increase in 2006, from around 100 to around 2,400 riyals. This value exceeded that of SABIC, a global company listed in the Saudi stock market. After the collapse, however, the authorities announced that these companies were losing money or were bankrupt.¹⁹² Whenever investor encounter difficulties in obtaining information on companies, they resort to media coverage as their channels for information delivery. In such coverage, information is disclosed in a way that deceives investor to believe that a given company exhibits excellent performance when the opposite is the case. Thus, quarterly announcements cause more surprise than do forecasts. Moreover, the fact that more than 50% of company shares are offered outside of trading exerts pressure on the trading process and causes an increase or decrease in share prices.¹⁹³

¹⁹⁰ Hamdi Al Juhani, *The Stock Market Crisis in 2006 is a Warning and a Call for Reforming* (Obekan Printing and Packaging 2006).

¹⁹¹ Company Bisha Agricultural Development is SAUDI Joint Stock Company, was established in Oct 1990. The company's capital fifty million Saudi riyals The company's activity in the administration of food and animal industries, especially canning and manufacture dates, and land ownership and trading of grains, seeds and agricultural equipment manufacturing.

¹⁹² Capital Market Authority (n 66).

¹⁹³ Capital Market Authority (n 126).

The CMA, devoid of carefully analysing and assessing the decisions, methods and actions they had selected, began to attempt to cope with the unpredictable market. As a consequence of these decisions hastily conducted by the CMA, the capital market became increasingly unpredictable and, therefore, a high proportion of investor were lost confidence about investing within the Saudi market. Overall, the financial crash in Saudi was generated by a convergence of a multitude of contributing factors. These included, limited investor experience and education regarding the risks of investment, too easily obtainable funds from banks and financial institutions which enabled and supported individuals from all kinds of backgrounds to invest their life savings, a half-hearted reaction from governing bodies regarding the revelation of insider trading, market manipulating and lack of disclosure.¹⁹⁴

Insider traders, including brokers, play a major role in the manipulation of the stock market. A study found that one of the reasons behind the crash of the Saudi stock market was that the inefficiency of brokers in the market caused significant delays in operation and with the consequence of associated high transaction costs. In addition, the situation was exacerbated by the fact that shares were routinely traded by unapproved and uncertified brokers. This contributed to the general sense of chaos within the market and an insecurity in share ownership. In addition, there was a dearth of independent professional trading brokers.¹⁹⁵

2.4 Role of Sharia Law in the Business Environment (insider trading, poor disclosure and market manipulation)

This section will present the role of Sharia to the business environment, and highlight specifically the impact of Sharia roles to the presented issues from investors protection prospective: insider trading, poor disclosure and market manipulation induced partly by market brokers.

Absolute monarchy is the form of government in Saudi Arabia and Royal Decrees are rooted in the Sharia'a law, which consists of a series of principles extracted from the Holy Qur'an, the Sunna, and other sources. Islamic law dictates the interpretation of the majority of Saudi regulations. Saudi law is mostly based on the Hanbali School of Islamic jurisprudence. This

¹⁹⁴ Al Juhani (n 187).

¹⁹⁵ Alsultan (n 175).

school possesses majority and minority perspectives on various matters and approaches legal interpretation according to the principles of justice and fairness. Islamic law explicitly prohibits *fasad*¹⁹⁶ and fraud. Furthermore, business practices that are predominant in the West, such as interest (*riba*) and uncertainty (*gharar*) are forbidden under the Sharia'a, and there is also no irrevocable power of attorney¹⁹⁷.

The human-God relationship as interpreted by Islamic theology is the core of Islamic law and implies individual obligations towards God, on the one hand, and towards other human beings, on the other hand¹⁹⁸. The two types of obligations mentioned above are respectively associated with worship (*ibadat*) and interactions (*muamalat*).¹⁹⁹ From an anthropological viewpoint, an understanding of the significance of these aspects for players in the Saudi business sector is essential for Western and non-Muslim readers.

The notions of responsibility in business and responsibility in the Qur'an, between an individual and others, and between an individual and God, are inextricably linked. All Muslims believe that every creature will be called to account for their actions on Doomsday, which is why they focus on leading a righteous life and comply with the Sharia'a²⁰⁰. The Sharia'a aims to protect against exploitation made possible by such illegitimate financial practices as insider trading, improper disclosure and market manipulation, meaning that Islam is the source of the Islamic principles governing the financial market²⁰¹.

However, due to the important role they play in societies, various different types of markets are allowed by Islamic Law, provided that rules and regulations are closely followed. Due to the great importance of markets, Islamic law has introduced rules and regulations intended to ensure fair market practices and avoid transgressions and damaging activities (e.g. cheating, fraud, stimulation, interest (*riba*) and uncertainty (*gharar*) endangerment (*al-taqreer*), *Al-najash* etc.). Therefore, market regulation is a major priority for rulers, with emphasis on monitoring

¹⁹⁶ Fasad: "is an Arabic word meaning rottenness, corruption, or depravity".

¹⁹⁷ Jeanne Asherman, 'Doing Business in Saudi Arabia: The Contemporary Application of Islamic Law' (1982) 16 Int'l L 321.

¹⁹⁸ Corporate Governance in Less Developed and Emerging Economies (Emerald Group Publishing 2008) 189-209.

¹⁹⁹ Quran, Surat Youse, Ayah 19.

²⁰⁰ Self –Accountability: The Link between Self - Accountability and Accountability in Islam' (n 2) Vol 2 No 5; 240.

²⁰¹ *ibid* 240.

of market activities and sanctioning rule violators²⁰².

Upon arrival in Medina, the Prophet (peace be upon him) observed that the Arabs suffered abuse from the Jews who controlled the market. Therefore, the creation of a market only for Muslims was among the first decisions he made in Medina. But he did not create this market without providing guidance, he set out rules and one day announced publicly: ‘Who cheats is not one of us’ cheating was seen as a big sin that would remove cheater from of the Muslim community. He also appointed some of his great companions to control and check regularly the attitudes and behaviours of people in the market²⁰³. Islamic law paid great attention to business and markets and protecting them from any sort of misconducts and manipulations.

The above example shows how Islamic law works, ensuring preservation of the aim of market creation by preventing market behaviours that could damage other market players or affect the stability of the market itself. The above discussion highlighted the extensive negative effects that stock market manipulation could have, calling for authorities to take proper measures to sanction it.

Market manipulation is considered a deviant behaviour in the stock market, an intentional offence rather than just a harmless activity. In the context of Islamic finance, for example, market manipulation is defined in more specific terms, as discussed in the following part. One definition of market manipulation is that of endangerment (al-taqreer), which can take three forms: putting individuals in dangerous situations; convincing someone to buy a product by misrepresenting the qualities of that product to make them sound better than they actually are; and convincing someone to act in a certain way by deceit²⁰⁴.

Endangerment and danger are not the same. Danger refers to something with an effect that is not known or the unknown among two allowances and the fairest is the best of them. On the other hand, danger and ignorance are similar to a certain extent. El Qrafi observed that what set these two terms apart was: He argued that danger referred to not knowing what was going

²⁰² Fahim Khan and Mario Porzio, *Islamic Banking And Finance In The European Union* (Edward Elgar 2010).

²⁰³ Saad Ali Aljloud, ‘The Law on Market Manipulation in Saudi Arabia : A Case for Reform’ (Ph.D., Brunel University London 2016).

²⁰⁴ Almaqdisiu Ibn Qudama, *Almaghni* (1st edn, Maktabat al-Qāhirah 2008).

to happen, just as selling birds or fish before catching them, whereas ignorance referred to the lack of knowledge about the nature of something that has happened and therefore was known, such as selling anything one possesses without knowing what one has²⁰⁵.

Danger differs from endangerment in that it refers to outcomes that are not known rather than to behaviour intended to deceive, as is the case with endangerment. Therefore, danger is associated with risk and endangerment is associated with deceit, which in turn results in risk. Based on how endangerment was defined at the beginning of this section and its associated terms, endangerment can be considered to be a type of market manipulation, as manipulation usually involves deceitful and fraudulent behaviour²⁰⁶.

About fraud, Ibn Qudama says: 'If one, with the intention of concealing a defect, hides it from the buyer instead of declaring it or covers it to delude the buyer into thinking that there is no defect, then they have committed fraud, meaning an injustice towards the buyer.' And it has been said that 'fraud can be committed in two ways: the first way is by hiding a defect and the other is by adding makeup to raise the price. From previous definitions it can be deduced that fraud is another form of market manipulation'²⁰⁷.

Deceit is the use of illegitimate means to reach an objective, without putting much thought into the action and without being noticed by others. Manipulation has this feature, seeking to achieve a purpose by presenting some things and not others. Both deceit and endangerment are used by a gyp to convince someone to make a purchase, thus generating profit for the seller. However, in cases where a sale is made based on deceitful promotion, a gyp can involve danger as well, which means that it can be classified as a unique type of manipulation²⁰⁸. Manipulation thus involves convincing others that profit can be made by acting in a certain profit, when this is not actually true. Is this sort of behaviour merely play or deceit and betrayal?

Manipulation usually takes the form of intentional oral communication of incorrect financial information for purposes of fraud, gyps, cheating, and hiding of faults, causing loss for traders. All types of manipulation are banned in financial markets and considered illegal. There is an abundance of evidence in the Holy Qur'an and the Sunnah pointing to the justification of

²⁰⁵ *ibid.*

²⁰⁶ Mohammed El Zarqa, *Al Madkhal Alfiquhi Alaam* (Dar Al-Qalam 1998) 463-464.

²⁰⁷ Ibn Qudama (n 200).

²⁰⁸ al-Bukhari Muhammad, *Sahih Al-Bukhari* (1999).

forbidding cheating and fraud. For example, Allah said: ‘O’ you believers, do not consume your wealth among yourselves in falsehood, except where you trade in mutual agreement. And do not kill yourselves. Allah is the most merciful to you’²⁰⁹.

Thus, manipulation and deception in financial transactions is forbidden. Qais ibn Saad ibn Ebada said, ‘The Prophet said, ‘the deceiving is in the hell’ [the text states the deceiving as an action is in hell; but it means the deceiver]’²¹⁰. Cheating leads to hell and, accordingly, it attracts a harsh punishment, which seeks to deter such behaviour. Omar's son said, “The Prophet forbids gyp”²¹¹. Gyp is detrimental to any contractor since cheating can artificially raise the price of a product; therefore, fraudulence, cheating and concealment in the financial market are forbidden. Therefore, The Arabic term gharar can be widely translated as deceit, risk, fraud, uncertainty or hazard that may result in damage or loss and applies to transactions of products of uncertain existence or description because contract outcome or the character/quality of the related subject matter is unknown²¹².

To give an example, according to the Prophet’s (pbuh) instructions, it is prohibited to buy animals yet-to-be-born, spoils of war before allocation, charities before they are received, and divers’ catch, as well as to sell milk from the udder without quantifying it. Any business transaction that is exploitative of or unfair to a contract party is expressly prohibited by Islam. Gharar is prohibited in commercial exchange contracts that are hazardous, risky or speculative in terms of the key transaction components or that are uncertain regarding a party’s upholding of its rights and obligations²¹³.

Such prohibition is intended to protect contract parties from lack of knowledge or fraud. To ensure equality between parties, every Islamic financial and business transaction must be transparent and correct, and all related information must be disclosed fully. Gharar is forbidden to make sure that contract parties are satisfied and provide full consent, which depends on

²⁰⁹ Holy Qur’an, Surat Al-nisa (4) Ayah 29.

²¹⁰ Muslim ibn al-Hajjaj Nisaboori, Sihih Muslim, Hadith Number: 102 (Darussalaam for Publication and Distribution 1999) 975.

²¹¹ Narrated by Mohammad Al Bukhari, Sahih Al-Bukhari, Hadith number 2142. (Darussalaam for Publication and Distribution 1999).

²¹² Mosab I. Tabash, ‘The Relevance of Islamic Finance Principles in Economic Growth’ (2014) 3 International Journal of Emerging Research in Management & Technology 11.

²¹³ *ibid.*

complete disclosure and transparency as well as comprehensive understanding of the opposing values that the contract parties wish to exchange. Protection from unforeseen loss and potential conflict about information quality or degree of comprehensiveness is achieved by forbidding gharar²¹⁴.

To develop a sense of affinity and collaboration in business relationships, Sharia'a encourages the concept of sharing profit losses among banking institutions and entrepreneurs. The equal distribution of loss between all parties could reduce the impact of loss. Nevertheless, to anticipate outcomes with sufficient reliability, precise and appropriate information must be available and contractual obligations must be free of even moderate risk and uncertainty²¹⁵.

No type of gambling is permissible in Islam either. Types of gambling transactions classified as completely unfair are maysir, whereby wealth is acquired effortlessly and by chance, regardless of the impact on other people's rights, and qimar, whereby wealth is acquired by chance at others' expense. It must be stressed that the Sharia'a does not forbid speculation that involves careful analysis of extensive economic and financial data as well as investment of assets, skills and labour, but speculation whereby profit is easily made through gambling. In the case of speculation based on analysis, buyers seek to make profit from transactions not via unfair acquisition of wealth at others' expense, but via trading²¹⁶.

One of the evidence for prohibited market manipulation appears from Al-najash²¹⁷, which refers to the practice of bidding high prices despite not intending to purchase, with the goal of increasing the price to produce greater benefits for the seller and more damage to the buyer. This practice provides the original support for interdiction of market manipulation²¹⁸. Imam Shafi' described Al-Najash: 'when the item is for bidding and someone offers a price without intending to buy it, just to make the others follow him, so they make higher offers.'²¹⁹ Even if they did not hear him, his intention alone makes him a sinner.

²¹⁴ *ibid.*

²¹⁵ Valentino Cattelan, 'From the Concept of Haqq to the Prohibitions of Riba, Gharar and Maysir in Islamic Finance' (2009) 2 International Journal of Monetary Economics and Finance 384.

²¹⁶ *ibid.*

²¹⁷ "Prohibited practice of deceiving and inciting a potential buyer of goods during the course of pre-sale negotiations or bidding to secure a greater value than the true worth of the goods".

²¹⁸ Risk Management in Islamic Finance (2008).

²¹⁹ Al-Shawkaani, M Neil al-Awtaar, Arabic edition (Dar al-Jeel 1973) 240.

Evidence from Hadith (Prophets' teachings) to inhibit Najash: a) Ibn Omar narrated that the Prophet (peace be upon him) inhibited Najash. In *Muatta'* (book of scholar Malik) Najash is defined as offering the seller a higher price than what is deserved, without intention to buy, just to stimulate others to offer more²²⁰. b) Abu Hurairah said: 'the Prophet forbade that a man in the city should be commissioner of a man in countryside and prohibited Najash and that a man makes an offer to sale while his brothers' is pending or makes a proposal for marriage while his brothers is pending or a woman should try to make her sister divorced to take her place.'²²¹.

Insider trading contravenes a number of key Islamic principles, so it is forbidden under Islamic Law. Those key principles are:

First: Fairness and justice, these principles are incompatible with insider trading, as this is a practice that gives one market player unjust advantage at the expense of other players. In the context of Islam, justice is understood as ensuring that something is in its lawful place and all people are treated equally²²². Insider trading has no fairness and justice because of the imbalanced access to undisclosed information, which will impact the price of securities when published, despite not all interested parties having knowledge of the nature of that impact²²³. Allah says in the Holy Qur'an concerning justice and fairness, "Be Fair and Just, that is nearer to piety (Taqwa)"²²⁴. In another Surah, Allah says, "And act justly. Truly God loves those who are just"²²⁵.

Secondly: Trustworthiness, until confidential information is disclosed publicly, insiders with knowledge of that information act as its 'trustees' and therefore are forbidden from abusing it to handle company securities. Violation of this principle is considered a violation of trust.

²²⁰ Narrated by Muslim, Hadith Number: 1516, (n 19).

²²¹ Narrated by Al-Bukhari, Hadith Number: 2033, (n 20).

²²² Hussin Mohd, 'Insider Trading From Malaysian Law And Islamic Law Perspectives' (Malaysian, Azmi & Associates 2008) <http://link.springer.com/10.1007/978-0-387-84831-0_7> accessed 25 February 2018.

²²³ Wunmi Bewaji, *Insider Trading in Developing Jurisdictions: Achieving an Effective Regulatory Regime* (Routledge 2012).

²²⁴ Holy Qur'an, Surat Al-Maidah, Ayah 8

²²⁵ Holy Qur'an, Surat Al-Hujurat, Ayah 9

Indeed, honesty and trustworthiness are highlighted as crucial principles in both the Qur'an and the Sunnah of the Prophet Muhammad (pbuh). Allah says in the Holy Qur'an, "Ye that believe! Betray not that trust of Allah and the Messenger, nor misappropriate knowingly things entrusted to you"²²⁶. It is narrated from Abu Hurayrah by al-Mundhari on the authority of both al-Bukhari and Muslim that the Prophet Muhammad (pbuh) said, "A hypocrite has three (3) signs: when he speaks he tells lies; when he makes a promise he does not fulfil it; and when he is entrusted with something he commits a breach of trust"²²⁷.

Third: The right to equal, quality and correct information: Market information is highly important in Islamic finance, the norm of Islamic ethics being breached if crucial information is not disclosed (ghish). The Sunnah of the Prophet Muhammad (pbuh) specifies that the party who did not have access to the same information as the other party when signing the contract can nullify the contract²²⁸. According to Islamic scholars, a transaction is Islamic only if it has no misrepresentation (jahalah). Thus, great significance is given to market transparency and it is even deemed to be an Islamic duty for all transactions to be carried out in the market once all the related information has been carefully considered²²⁹.

The dishonest practices of market manipulation, insider trading and poor disclosure are considered offences because they involve illegitimate appropriation of assets. Despite seeming similar to theft, the act involves a higher degree of sophistication, without any aspects of physical appropriation. Market abuse is typically classified as tazir²³⁰ under Islamic law, and therefore the decision regarding the punishment falls to the ruler. Basically, tazir represents the ruler's discretionary power, the exercise of which is subject to legal restrictions that are more like standards instead of rules²³¹.

Tazir is not subject to rigid evidence rules applicable to other types of punishment because it is considered a strategy for meeting practical purposes of public order and moral maintenance.

²²⁶ Holy Qur'an, Surat Al-Anfal, Ayah 27.

²²⁷ Narrated by Al-Bukhari, Hadith Number: 33, (n 20).

²²⁸ Mohd (n 218).

²²⁹ Ibnrubbian (n 7).

²³⁰ In Islamic law there are three primary classifications of offences Hadd, Tazir and Qisas.

²³¹ Hossin Esmaeili and Jeremy Gans, 'Islamic Law across Cultural Borders: The Involvement of Western Nationals in Saudi Murder Trials' (1999–2000) 28 Denv J Int'l L & Pol'y 145.

Nevertheless, in the context of Islamic finance, tazir is deemed an appropriate tool for punishing individuals carrying out manipulative practices²³².

As well narrated by Amro Ibn Shuaib through his father through his grandfather who heard a man from Muzaina asking the Prophet (peace be upon him) on his opinion on a lost camel he replied: 'Do not worry about it, it has its food and foot' the man asked what about sheep, the Prophet replied: 'for you or your brother or wolf', the man asked again if someone took it from the pasture, he answered he will be punished and fined its price, and if he released it from its tether or taken out of its yard his punishment is to cut his hand, the man asked, 'O you Prophet, what about fruit while on tree', he said: 'no problem if it is just to eat but if he took it he will be punished and fined its price (in another version he will be fined twice its price)',²³³.

The Prophet's sayings (Ahadeeth) state that individuals involved in practices of share price manipulation should be punished for deceitful action, as well as that the punishment must be clear to ensure that the consequences of market manipulation are known to all. More specifically, there are three types of punishments, which are fixed, range and proportional punishments²³⁴. This liaison can take a variety of forms. One such form that has not been addressed is the relationship between brokers and buyers/sellers; brokers act as representatives of buyers/sellers, so from a legal perspective, the brokers are the buyers/sellers and therefore any occurring faults will be attributed to the brokers. Naturally, several additional features are examined to determine whether the offence was intentional or unintentional²³⁵.

However, IOSCO published guidelines for regulators responsible for overseeing the provision of products conforming to Sharia'a, thus addressing the unique characteristics of Islamic financial markets and the necessity to protect Muslim investors. Those guidelines highlight aspects that have not been addressed by the Saudi government and that require scrutiny²³⁶.

²³² *ibid.*

²³³ Narrated by Abu Dawood, Hadith number: 1710 (Darussalaam for Publication and Distribution, Saudi Arabia 1999).

²³⁴ Aljloud (n 199).

²³⁵ *ibid.*

²³⁶ Ibnrubbian (n 7).

In the guidelines for Islamic capital market regulators, IOSCO specifies that securities regulators must indicate whether they are also in charge of regulating compliance with Sharia'a, and if so, they must provide clear and legitimate reasons for their course of action and/or interpretations. According to some researchers, regulation of compliance with Sharia'a should not be a responsibility of capital market regulators, who should only be responsible for implementing the procedural rules for evaluation of compliance²³⁷.

The fact that Saudi governmental authorities are responsible for making sure that products in the Saudi capital markets are compliant with Sharia'a is not explicitly stated anywhere in the 2003 Capital Market Law or the CMA Regulations. However, the assumption that standard legal and financial due diligence assessments of offers of securities put forth include Sharia'a-compliance is incorrect. No requirement to validate that offered securities are compliant with Sharia'a is actually included in the Capital Market Law and CMA regulations.⁹⁸ In general, the proposed issuer is left to deal with this matter as deemed fit, depending on the relevance or importance to the intended investors²³⁸.

Verification of securities transactions to ensure they comply with Sharia'a has both strong and weak points. Sharia'a dominates Saudi law, so a certain level of supervision is to be expected. On the other hand, the CMA lacks the capability and resources to assess compliance with Sharia'a. Inspection of aspects related to Sharia'a should be the responsibility of international non-governmental institutions to avoid unsettlement by investors whose actions and decisions are based on religious principles. Such institutions could devise not only Sharia'a standards, but also rules for how Sharia'a boards should be established and operated. Cross-jurisdictional uniformization of standards and promotion transaction fluidity across borders should be the aim of international implementation of Sharia'a standards²³⁹.

²³⁷ *ibid.*

²³⁸ *ibid.*

²³⁹ *ibid.*

2.5 The Legal Structure of Judicial system in Saudi Arabia; and its subsequent development.

2.5.1 Introduction

Islamic law or 'Sharia' takes source primarily from the Quran, the book believed by Muslims to have been divinely descended onto prophet Mohamed through Angel Gabriel, as well as the sayings and actions of the prophet Mohamed. Secondary and subordinated sources include the interpretations and elaborations delivered by scholars in relation to the primary sources. Secondary sources are subject to debate²⁴⁰.

Traditionally, Muslims hold mostly in high regard the interpretative rulings of four main scholars: Imam Abu Hanifa, Imam Mohammad Shafei, Imam Malik Ibn Anas and Imam Ahmad Ibn Hanbal. Every one of those scholars has amassed a significant level of respect. The four schools of Islamic jurisprudence, though looked upon distinctively, agree and disagree in opinion on different matters. Within each school, in turn, minority and majority opinions exist amongst the scholars within them. The Saudi Arabian legal system focuses in great part on the school of Imam Ahmad Ibn Hanbal, although not exclusively.²⁴¹

Sharia was described by some as a "way of life" since it governs not only the public but also the private aspects of a Muslim's day-to-day life, including faith, worship, body care, and interactions with other (including commercial interactions).²⁴² From the perspective of Muslim society, Sharia's scope extends to economic, political, cultural and social matters²⁴³.

Sharia commandments are broad for the great part, save for a few precise ones. Broad commandments include those related to the respect of the rights and property of others, the honoring of commitments, sincerity in transacting, etc. To illustrate, Verse 2:188 of the Quran states that: "And devour not each other's property among yourselves wrongfully, nor seek to gain access to that by bribing judges so that you devour a part of the property of men wrongfully while ye know"²⁴⁴.

²⁴⁰ Ahcene Lahsasna and M Kabir Hassan, 'The Shariah Process in Product Development and Approval in ICM' in M Kabir Hassan and Michaelhlknecht (eds), *Islamic Capital Markets* (John Wiley & Sons, Inc 2012).

²⁴¹ Anthony Shoult, *Doing Business with Saudi Arabia* (GMB Publishing Ltd 2006).

²⁴² Lahsasna and Hassan (n 236).

²⁴³ 'Report of the Islamic Capital Market Task Force... -' (2004) <https://scholar.google.com/scholar?hl=en&as_sdt=0%2C5&q=%27Report+of+the+Islamic+Capital+Market+Task+Force+of+the+International+Organization+of+Securities+Commissions%27+%28July+2004%29&btnG=> accessed 20 February 2018.

²⁴⁴ Holy Qur'an, Surat Al- Baqarah.

As it is partially a human creation and partially divine commandment, the Saudi legal system is defined by researchers as ‘bifurcated’ or in ‘duality’.²⁴⁵ The Saudi government does have legislative powers, but no law of human creation is more important than the Sharia’a, as stated in the constitution.²⁴⁶ Compliance with Sharia’a is required in every aspect of Saudi society, and the legislative, executive and judicial authorities are no exception. Sharia’a rules must be strictly applied to all legal transactions, judicial ruling, policy, law and even constitution. Therefore, Sharia’a must be considered in investigations of aspects of the Saudi legal system, such as capital market institutions and transactions.²⁴⁷

Muslims must not deal with financial products that do not comply with the Sharia’a otherwise they may be punished by losing their spiritual status in the hereafter. Furthermore, Muslims should not invest in products if they are unsure whether those products comply with Sharia’a. Due to these restrictions, international financial institutions have had to develop special products acceptable to Muslim investors.²⁴⁸ There are three types of shares, based on the stipulations of the Sharia’a, namely, halal or legitimate shares, “mixed” shares, and forbidden or haram shares. Halal shares are those shares that conform to Islamic law completely and indicate the legitimacy of the activities and funding sources of an organisation under Sharia’a. The majority of shares in the Saudi agricultural industry are halal²⁴⁹.

“Mixed” shares refer to the fact that the business operations of an organisation are halal and comply with Islamic law, but some of its funding sources are illegitimate. Even though it is halal to invest in this kind of equity, investors have to relinquish a portion of their profits corresponding to the profits obtained from operations associated with illegitimate funding sources. Traded securities in the Saudi industrial, cement and service sectors are considered

²⁴⁵ Prophet Mohamed was quoted as saying: "[e]ach of you is a Sheppard, and each of you will be accountable for his flock" (Ṣaḥīḥ al-Bukhārī 6719, Ṣaḥīḥ Muslim 1829)

²⁴⁶ Ali Adnan Ibrahim, ‘The Rise of Customary Businesses in International Financial Markets: An Introduction to Islamic Finance and the Challenges of International Integration’ (2007–08) 23 Am U Int’l L Rev 661.

²⁴⁷ Frank E Vogel, *Islamic Law and the Legal System of Saudi Arabia* (BRILL 2000).

²⁴⁸ Salman Syed Ali, ‘Islamic Capital Market Products - Developments & Challenges (Occasional Papers)’ (Occasional Paper, The Islamic Research and Teaching Institute (IRTI) 2005).

²⁴⁹ Saleh Mutawa, *Securities and Applications Disputes in Saudi Arabia: Administrative - Criminal - Compensation* (King Fahd National Library 2015).

mixed shares. Forbidden or haram shares cannot be bought or sold under Islamic law and they are associated with organisational activities involving payment or interest application. Shares in the banking industry with express payment or taking of interest are classified as haram shares²⁵⁰.

2.5.2 The Saudi Legal System

As mentioned in the first chapter, there is an increasing volume of market theory literature showing the significance of institutional structures and legal systems for the development of stock market and their participants. Therefore, as a precursor to this paper, it is important to briefly present the main features of the Saudi legal system, and to review its unique characteristics in order to offer a solid understanding of current stock market regulations.

As the Kingdom of Saudi Arabia in this era committed to Islam as a religion, and the Quran²⁵¹ constitution and Islamic Sharia regulations and legislation, Kingdom tended to organize the judiciary to be a practical application of Islamic justice system, with the development and expansion in line with the needs of the times, and the expansion of the work of the state, and the large number of disputes and lawsuits. Kingdom adopted a gradual and development approach, which issued several paint systems for judges of their approach in the light of Sharia, and this is what I am studied and presented in this section. The legal system of Saudi Arabia is based on Islamic law (sharia) derived from the Qu'ran and the Sunnah²⁵² (the traditions of the Islamic prophet Muhammad), Ijma²⁵³ and Qiyas.²⁵⁴

²⁵⁰ *ibid.*

²⁵¹ Qu'ran: sacred text of Islam, divided into 114 chapters, or suras: revered as the word of God, dictated to Muhammad by the archangel Gabriel, and accepted as the foundation of Islamic law, religion, culture, and politics.

²⁵² Sunnah: The way of life prescribed as normative in Islam, based on the teachings and practices of Muhammad and interpretations of the Koran. Also called hadith.

²⁵³ Ijmā': is an Arabic term referring to the consensus or agreement of the Muslim community. Various schools of thought within Islamic jurisprudence may define this consensus as that of the first generation of Muslims only; the consensus of the first three generations of Muslims; the consensus of the jurists and scholars of the Muslim world, or scholarly consensus; or the consensus of all the Muslim world, both scholars and laymen.

²⁵⁴ Qiyas: To establish and obtain a decision, a rule and judgment for a case due to a certain cause just because of the existence of the similar cause, rule and judgment in an other particular case.

In addition, Saudi law depends on regulations issued by the royal decrees²⁵⁵ (not contrary to Islamic law), which covers a number of modern issues such as intellectual property and corporate law. However, the remaining Shari'a is the primary source of law, particularly in the areas of criminal, family, commercial, contracts, and the Quran and Sunnah are the country's constitution. Saudi Arabia is the only country in Muslim world that its legal system relies in sharia without notation, which is mean that there is no system of judicial precedent. This system differs from other in legal systems recognized internationally, whether part of the Latin School of Law (such as Egypt - France) or within the Anglo-Saxon law school such as (Britain). There is considerable ambiguity surrounds the field of Saudi law. This later led to the declaration of the state intention to codify the rules of Sharia in 2010.²⁵⁶

However, with regard to Saudi judicial system which consists of general courts and specialized tribunals. The Shariah court system in the kingdom (the general courts) under the authority of the Ministry of Justice it is already in the competence and jurisdiction and the other serves as the exception, this court is concerned with the types of quality issues, whether in Rights or Marriages or felonies or evidence. Etc. unless the law specifies otherwise. The Civil Courts under the jurisdiction of the Board of Grievances and other agencies have the exclusive authority to decide upon disputes Government and commercial contracts, taxation, banking and labour issues.²⁵⁷

Due to the fact that the Saudi legal system is based on Shariah law, the Shariah Court System, under the jurisdiction of the Ministry of Justice, serves as the country's general courts, and Shariah judges preside over any dispute arising within the Kingdom unless these disputes are excluded by law²⁵⁸. The first organization of a Shariah court system goes back to 1927 when King Abdul Aziz issued a Royal Decree unifying the judicial system in the country. The first

²⁵⁵ Royal decrees: A decree is a rule of law usually issued by a head of state (such as the president of a republic or a monarch), according to certain procedures (usually established in a constitution). It has the force of law.

²⁵⁶ Vogel (n 243).

²⁵⁷ Campbell, C (2007). Legal Aspects of Doing Business in the Middle East. 3rd ed. UK: Yorkhill Law Publishing. 25.

²⁵⁸ Saudi judicial Regulations, issued under the Royal Decree No. 64, dated 14/7/1397, Art. 26 states that Shariah courts have exclusive jurisdiction over all disputes and crimes except matters that are excluded by Rules.

step towards achieving justice and organization of courts issuing the Royal Decree (King Abdulaziz) in 1927 in the 24 articles as «system configurations Sharia Courts, which was the organization of the courts, and classification, and their terms of reference judiciary, The Shariah court system classified courts into three categories: Expeditionary Courts, Shariah Courts, and Shariah Courts.²⁵⁹

The first organization of the court system classified courts into three categories: Expeditionary Courts, Shariah Courts, and the Commission for Judicial Supervision. This system has remained the main basis for the judicial system in the Kingdom. At present, the new judicial system concerned about multi-courts of general jurisdiction and diversity within the judicial system of the state, where Article IX of the Basic Law, rearranging and organized the ordinary courts and tribunals which divided into three types.²⁶⁰

2.5.2.1 The Saudi Judicial System

The Saudi judicial system consists of general courts and specialized tribunals. The Shari'a court system in the Kingdom (the general courts) is under the authority of the Ministry of Justice; it has full competence and jurisdiction over issues concerned with, for example, rights, marriage, crime, presenting evidence, etc., unless the law specifies otherwise. On the other hand, the Civil Courts are under the jurisdiction of the Board of Grievances, and certain other agencies have exclusive authority to decide upon Government disputes, commercial contracts, taxation, banking and labour issues.²⁶¹

2.5.2.1.1 The Shari'a Court System

Due to the fact that the Saudi legal system is based on Shari'a, the Shari'a court system, under the jurisdiction of the Ministry of Justice, serves as the country's general courts, and Shari'a judges preside over any dispute arising within the Kingdom, unless such competence is excluded by law. The first Shari'a court system goes back to 1927 when King Abdul Aziz issued a Royal Decree unifying the judicial system of the country. There were 24 Articles,

²⁵⁹ Vogel (n 243).

²⁶⁰ *ibid.*

²⁶¹ Campbell, C (2007). *Legal Aspects of Doing Business in the Middle East*. 3rd ed. uk: Yorkhill Law Publishing. P25.

which sought to delineate the competencies of the judiciary; accordingly, the Shari'a court system was classified into three categories: Expedition Courts, Shari'a Courts and the Commission for Judicial Supervision. This system has remained the main basis for the judicial system in the Kingdom. The present judicial system incorporates multi-competence courts (of general jurisdiction), reflecting diversity within the judicial system of the state. Thus, Article IX of the Basic Law organizes the ordinary courts and tribunals into three types: the Supreme Court, the Courts of Appeal and the Courts of First Instance.²⁶²

2.5.2.1.1.1 The Supreme Court

The Supreme Court is the highest judicial authority over the Saudi courts of general jurisdiction. According to the justice system, the Supreme Court in the city of Riyadh is at the top of the judicial organization in the Kingdom, and it is composed of a number of judges ranking Chief of the Court of Appeal. The Supreme Court is designed to monitor the application of the provisions of the Shari'a and the regulations issued by the King. It has the following competencies: reviewing judgments and decisions issued by or supported by the appellate courts (concerning severe sentencing), reviewing the judgments of a court that was not competent or deemed in error in its judgements, and determining whether a court is properly constituted as stipulated in the justice system.²⁶³

2.5.2.1.1.2 The Courts of Appeal

The second level of the Shari'a court system is the Courts of Appeal, which has the general mandate to hear all appeals from the Courts of First Instance. Their function does not stop at adjudicating the sentence being appealed, but includes issuing new guidelines based on any new facts and may extend to establishing new legal rules and statutory court procedures for secondary appeals. Any decision made by the Courts of Appeal is usually the last word on the case. For the justice system to be equitable, the Saudi government has established in every

²⁶² Saudi judicial regulation, issued under the Royal Decree No. 64, dated 14/7/1397, Art. 26 states that Shariah courts have exclusive jurisdiction over all disputes and crimes except matters that are excluded by Rules.

²⁶³ Ministry of Justice. (2011). The Supreme Court. Available: <http://www.moj.gov.sa/ar-sa/Courts/Pages/HighCourt.aspx>. Last accessed 6th April 2013.

district at least one Court of Appeal. Each Court of Appeal hears cases with three judges, with the exception of cases concerning severe sentencing, in which five judges sit.²⁶⁴

2.5.2.1.1.3 Courts of First Instance

In the Saudi justice system, Courts of First Instance are present in all provinces and regions of the Kingdom; these courts have wide jurisdiction and pass judgments on all ‘ordinary’ cases. The verdicts are subject to appeal, except any cases that are referred to the Supreme Judicial Council. Given the diversity of cases that fall under their remit, Article IX of the newly re-arranged justice system has organized them into five types, namely: general courts, criminal courts, personal status courts, labour courts and commercial courts.²⁶⁵

2.5.2.1.1.4 The General Courts

The General Courts are distributed across all regions of the Kingdom; they consist of a single judge or sometimes three judges, as determined by the Supreme Judicial Council. A single the General Court judge may not sit on cases involving murder, stoning or amputation, which are determined by three judges. The General Courts specialize in lawsuits relating to property and *waqf*²⁶⁶ (property endowment held in trust and used for charitable or religious purposes), and to the *sukuk* (bonds) that relate to property or *waqf*; they also specialize in lawsuits arising from traffic accidents and violations of the traffic laws.²⁶⁷

2.5.2.1.1.5 Criminal Courts

Criminal Courts are also distributed across all regions of the Kingdom. They constitute three judges, except in cases specified by the Supreme Judicial Council, which are seen by a single judge. The Criminal Courts have jurisdiction in all criminal cases.²⁶⁸

²⁶⁴ Hoshan, M & Abu Saif F (1975). introduction to the study of regulation. Alexandria: Modern Egyptian Bureau of Printing and Publishing . P45-52.

²⁶⁵ Ministry of Justice. (2011). The Supreme Court. Available <http://www.moj.gov.sa/ar-sa/Courts/Pages/First.aspx>. Last accessed 10th April 2013.

²⁶⁶ Wakf: is an unconditional and permanent dedication of property with implied detention in the ownership of God in such a manner, that the property of the owner may be extinguished and its profits may revert to or be applied for the benefit of mankind except for purposes prohibited by Islam.

²⁶⁷ Ministry of Justice. (2011). The Supreme Court. Available <http://www.moj.gov.sa/ar-sa/Courts/Pages/First.aspx>. Last accessed 10th April 2013.

²⁶⁸ *ibid*.

2.5.2.1.1.6 Personal status courts

Personal Status Courts have several sections, and each has a single judge or sometimes more, as determined by the Supreme Judicial Council. These courts too are located in all regions of the Kingdom. Personal Status Courts consider all matters pertaining to proof of marriage, divorce, annulment of marriage, custody, alimony, wills, births and deaths, determination of heirs and inheritance.²⁶⁹

2.5.2.1.1.8 Labour courts

These are located in all the governorates and regions of the Kingdom. The Labour Courts have several sections, with each section having a single judge (or sometimes more), and have jurisdiction over disputes relating to employment contracts, wages and rights, and work-related injuries and compensation. They also adjudicate over the penalties stipulated in the Labour Law, and disputes arising from termination of employment, which may include complaints made by employers or workers and disputes relating to workers subject to the Provisions of Employment; these include government employees. Finally, disputes arising from the application of the Employment and Social Security system are settled by the Labour Courts.²⁷⁰

2.5.2.1.1.9 Commercial courts

These are distributed across all regions of the Kingdom. Commercial Courts are composed of specialized departments, and each one has a single judge or more, as determined by the Supreme Judicial Council. Commercial Courts have jurisdiction over the following: all disputes that occur between merchants, claims made against a merchant because of some aspect of his business, and disputes that occur between partners in companies. Moreover, the Commercial Courts are specialized in all claims and irregularities relating to the Saudi commercial system as well as to declaring and lifting bankruptcy.²⁷¹

²⁶⁹ *ibid.*

²⁷⁰ *ibid.*

²⁷¹ *ibid.*

2.5.2.1.2 The Supreme Judicial Council

The Supreme Judicial Council is headed by the President and Senior Associate, who has a Deputy and four Senior Judges. It has a variety of missions, but the most important is administrative; this concerns supervising the work of the courts described above, and it represents the only source of reference for all judicial departments in terms of their legal and administrative aspects. Moreover, it mediates between the judiciary and all the other ministerial departments and institutions; the Supreme Judicial Council receives all orders, instructions and regulations issued by the government and sends them on to the various jurisdictions. It also checks all court decisions and advisory *fatwas*²⁷² (legal judgements made an Islamic scholar), and considers complaints against judicial departments or staff. Finally, it monitors the work of the staff in all judicial departments as well as their recruitment, and promotes and dismisses judges.²⁷³

2.5.3 Historical Development of the Saudi Judiciary

In 1926, King Abdul Aziz issued instructions announcing interim reforms to the judiciary; these instructions were entitled “Temporary remedial materials to the Islamic courts”. He explained then in his speech (published in newspapers on 16/01/1926) that the provisions of Islam would form the basis for the governing of Saudi Arabia. In 1927, King Abdul Aziz ordered however that Ottoman law would continue in Hijaz²⁷⁴; he said, Ottoman law has existed for some time, so we agree to your proposal on the continuation of the provisions of that law. Moreover, in 1928 the King issued a new law: ‘Conditions of Shari’a Courts and their Formation’, which was the first administrative system in Hijaz.²⁷⁵

King Abdul Aziz asserted that Saudi courts would follow the provisions of Shari’a without being constrained by any specific Islamic school. However, in 1928 a royal order was issued

²⁷² Fatwas: are formal legal opinions issued by a recognized religious legal authority. Fatwas are most frequently issued in response to questions about living everyday life in accordance with religious law.

²⁷³ Al-training, S (1999). Judicial organization in the Kingdom of Saudi Arabia in the light of Islamic law. Riyadh: Imam Islamic University. P428.

²⁷⁴ Hijaz: region of northwest Saudi Arabia on the Gulf of Aqaba and the Red Sea. It includes the holy cities of Mecca and Medina.

²⁷⁵ Al-training, S (1999). Judicial organization in the Kingdom of Saudi Arabia in the light of Islamic law. Riyadh: Imam Islamic University. P280-285.

requiring judges to work under the Hanbali²⁷⁶ School in general and in the event of any departure from that doctrine evidence must be presented. In 1950, the King issued a regulation entitled ‘Legitimate Conduct of Trials’, which illustrated the auditing provisions.²⁷⁷

In 1937, ‘Law on Pleadings’ was issued, which was more detailed than its predecessor; it was reissued in 1953 under the name ‘Administrative Organization of Working in the Law’. In addition, in 1939 the King issued ‘Concentration of the Responsibilities of the Religious Judiciary’, to ensure that the judiciary would be an official institution recognized across the whole country; it consists of eight chapters and 282 articles, and is the longest justice document in the history of the Kingdom. In 1975, a regulation simply entitled ‘The Judiciary’ was issued, and in 1982 regulations for the Board of Grievances were established.²⁷⁸

In addition, on 01/04/1990 Cabinet Resolution No. 60 was issued, containing the approved list of discrimination provisions for legitimacy, while still working on ‘Instructions for Discrimination of Legal Provisions’, which was issued in 1967. Moreover, from 2001 to 2007 several laws and regulations were issued, including ‘Legitimate Arguments’ as well as the law on ‘Criminal Procedure’ and ‘The Practice of Law’. Also in 2007 the laws governing the judiciary and the Board of Grievances were amended.²⁷⁹

2.5.4 Stages of the Enactment of New Regulations in Saudi Arabia

The passage of a law entails several stages, require constitutionally supported legislation before it can come into force, and these stages are:

²⁷⁶ Hanbali: one of the four schools of Islamic law, founded by Ahmad ibn Hanbal, predominating in Saudi Arabia.

²⁷⁷ Supreme Judicial Council. (2011). Historical Development of the Saudi Judiciary. Available: <http://www.scj.gov.sa/index.cfm?do=cms.conArticle&contentid=1144&categoryid=385>. Last accessed 28th May 2013.

²⁷⁸ *ibid.*

²⁷⁹ Hammad, A. (2010). Judicial organization in Saudi Arabia . Available: <http://www.afaqlaws.net/Views/ViewResearch.aspx?artid=2>. Last accessed 29th May 2013.

2.5.4.1 Proposal

This represents the first stage of the process for enacting new regulations, and it starts with preparing a draft, which is presented to the legislature, represented by the Council of Ministers. Legislation is in place that determines the persons who are entitled to propose a draft law, who are members of the legislature or of the executive (government). According to Article 22 of the Regulations for the Council of Ministers, any Minister can also present a draft law to the Council if it deals with matters that are under that Ministry's jurisdiction.²⁸⁰ Moreover, the Minister has the right to propose new regulations in the public interest. After accepting the proposal, it is transferred to the Consultative Department, which is under the jurisdiction of the Council of Ministers, and which consists of a number of legal experts, who then study, consider and evaluate the proposed regulation. Following this, the proposal is prepared as a final draft and then submitted as a report to the Council of Ministers.²⁸¹

2.5.4.2 Debate and vote

This is the second stage for a draft law, wherein the legislature approves or rejects it through a majority vote, as determined by the appropriate law. After the Consultative Department has submitted its report to the Council of Ministers, the Council functions a legislative body and reviews that report, discussing it article by article. The Council then votes on the project and should it be approved, the draft is referred to the Royal Court to be endorsed by the King. If the Council of Ministers refuses the draft submitted by the Consultative Department, then it is shelved.²⁸²

2.5.4.3 Ratification

If the Council of Ministers approves the proposed law or regulation, it sends the draft to the Royal Court for submission to the King but he has the right to make objections or to reject it. Should this happen, the King (within one month) must indicate his reasons for rejection, and

²⁸⁰ The Council of Ministers Law. (2013). The Law of the Council of Ministers-Saudi Arabia . Available: http://www.saudiembassy.net/about/country-information/laws/The_Law_of_the_Council_of_Ministers.aspx. Last accessed 28th June 2013.

²⁸¹ Omran, M & Others (1997). Introduction to Regulation in the Kingdom of Saudi Arabia. Riyadh: King Fahd National Library. P106.

²⁸² *ibid.*

upon receipt by the Council of Ministers of any rejection by the King, the Council re-examines the project; in the case of a second approval, the Prime Minister shall take whatever action he deems appropriate and informs the Council accordingly.²⁸³

2.5.4.5 Royal Decree

A parallel procedure in monarchic systems is that the Head of State in his capacity as head of the executive branch directs its members to put a new law into effect. In Saudi Arabia, the statutory instrument for the issuance of such new laws is the Royal Decree.²⁸⁴

2.5.4.6 Promulgation and enforcement

Following Royal approval, all citizens must be informed of the new law and made aware of its provisions; this is achieved through publication in national newspapers. From the date of publication, the new law comes into effect. However, there are other types of regulations, known as Subsidiary Regulations, which are issued by government agencies, and operate to elaborate on the Statutes and to offer additional specific details to existing legislation. Therefore, by using the powers delegated to the Council Ministers, this category of regulations is enacted by one or more of the Council members. Also, royal or ministerial approval is not required in this level of legislation. This kind of regulation authorizes government agencies to issue the necessary rules for the performance of their duties in an effective manner, and to enable them to operate in a more streamlined manner, without requiring them to consult the relevant legislative bodies. Thus, legislation in the Kingdom of Saudi Arabia divided into two types: Basic System of Government and Subsidiary.²⁸⁵

The supreme legislative authority in Saudi Arabia is the Constitution, which is a set of rules that describe the basic functions and parameters of the state as well as the form they must take. Through the identification of religion, language and the authorities that hold the burdens of government, these general principles determine the rights of the citizens, and this basic form of legislation in the Kingdom of Saudi Arabia empowers the King to issue statutes by Royal Order. These regulations issued by the State regulate various aspects of economic and social

²⁸³ *ibid.*

²⁸⁴ *ibid.*

²⁸⁵ *ibid.*

life, for example, commerce, and labour regulations amongst others. This power accords the regulatory authorities within the Kingdom the right to enact laws and regulations so as to achieve the national interest or to stop corruption.²⁸⁶

As Sub Regulation (mentioned above) is the lowest form on the legislative ladder in the legal system of Saudi Arabia, any such regulation or legislation must be consistent with higher legislation that already exists, and should not modify or revoke or be inconsistent with higher legislation. Usually, subsidiary legislations are issued by the Council of Ministers, or the competent Minister, or any person who is authorized to enact new rules. Nevertheless, for primary legislation, there are three stages for the enactment of laws other than supreme legislation (which is issued by Royal Decree), which should be passed by the legislature, consisting of the Consultative Council, the Council of Ministers and the King's approval. According to the development of statutory amendments and regulations governing such activities as commerce, trade, business, labour, taxation, customs and banking, special courts must be established to settle disputes. These disputes can have a significant impact on the judicial system and on the design of the courts of the Kingdom, as will be explained in the next section.²⁸⁷

2.6 Regulatory Structure of the Saudi Stock Market

2.6.1 Capital Market Law

The Financial Market Law restructured the capital market to boost confidence on the basis of transparency. The Council of Ministers approved the implementation of this law in 2003. This law marks an important qualitative leap in the history of the Saudi capital market. It is designed to restructure the capital market in the Kingdom based on new and sophisticated standards to enhance the confidence and attractiveness of the market and to ensure the provision of more disclosure, transparency, protection, and justice for client. Under its new structure, the financial market contains the following components and elements.²⁸⁸

²⁸⁶ Omran, M & Others (1997). Introduction to Regulation in the Kingdom of Saudi Arabia. Riyadh: King Fahd National Library. P107.

²⁸⁷ Sadiq, M (1965). The Development of the Authority and Administration in the Kingdom of Saudi Arabia. Riyadh: Institute of Public Administration Press. P32.

²⁸⁸ The Capital Market Law, pursuant to Royal Decree No M/30, dated 31 July 2003 (CML).

The Capital Market Law serves as an umbrella law and an integrated organizational reference for the market. It specifies the main principles and foundations that cover all aspects of the market in terms of identifying supervisory, regulatory, and operational structures and institutions for the market; determining their powers and functions; and disclosing and disseminating information whether in the primary market or secondary market (trading). It is aimed at curbing the exploitation of information and rumours and provides for penal sanctions order to ensure justice in the market.²⁸⁹ This law also determines the roles and functions of the new supervisory, regulatory, and operational financial institutions in the market and defines the separation of regulatory and supervisory roles as well as executive and operational roles. This law separates these roles through the establishment of the following new market institutions.²⁹⁰

First of all: The Capital Market Authority is a regulatory and supervisory body that oversees the market. It has financial and administrative independence and reports directly to the Prime Minister. The regime has granted broad powers and authority to this body so that it can perform its duties and functions and fully play its role.²⁹¹ This body serves to organize and develop the financial market, issue regulations necessary to implement the provisions of the law, achieve appropriate justice and efficiency in issuing securities, and provide justice and full disclosure in companies to protect investor and securities dealers.

The stock market is created and entrusted with the executive and operational functions of the market; it is generally described as a joint stock company and is the only party authorized to conduct business as a formal market for the trading of securities in the KSA. The regime has devoted a special chapter to the financial market and its objectives, which include ensuring equity and efficiency in trading, ensuring transparency of listing requirements and trading systems, providing safe and fast regulations with high level of efficiency for settlements, and creating and applying professional standards for market intermediaries and their agents. This chapter also identifies how to form a board of directors and the actors represented therein from the public and private sectors.²⁹²

²⁸⁹ Capital Market Authority. Capital Market Law.

²⁹⁰ *ibid.*

²⁹¹ *ibid.*

²⁹² Tadawul. Articles of Association of the Saudi Stock market Company (2014). Available: http://www.tadawul.com.sa/wps/portal!/ut/p/c1/04_SB8K8xLLM9MSSzPy8xBz9CP0os3g_AewIE8T

A Securities Disputes body for the purpose of inquiries and an Appeals Committee consisting of legal advisers with expertise in law and jurisprudence of transactions, commercial and financial matters, and securities was established. This committee has the jurisdiction to hear and determine all claims, disputes, and offenses relating to securities and that fall within the provisions of the rules, regulations, and instructions issued by the Authority for the market and the public and private sectors.²⁹³

A department called SDC was created within the market. This body was responsible for carrying out deposit, transfer, settlement, and clearing operations and registration of securities traded in the market. This was the only entity in the Kingdom authorized to perform this work. According to the law, entries in the records are considered evidence and conclusive proof of the ownership of securities.²⁹⁴

To ensure disclosure and transparency in the financial market, the law devotes a separate chapter to these issues. As per the law, any source of a security or an underwriter cannot place any financial security on the market without providing a prospectus to the Commission and gaining its approval. This prospectus must contain key information and data. Annual and quarterly reports must be provided to the Authority, and any issuer of securities must inform the Authority of any significant events that may affect the price of the securities.²⁹⁵

Another chapter covers fraud and insider trading of information, which are prohibited in the market. Thus, the law prohibits fake trades that are conducted to influence the prices of securities traded in the market although they do not lead to any real transfer of ownership of securities. The law also prohibits any deal based on inside information available to some people but not to the general public and that has not been announced.²⁹⁶

IwMLj2AXA0_vQGNzY18Q1wAoH4kk7x4QZmrgaeITbBQc4GVs4GLEQHdwap6-n0d-bqp-QW5EOQDHSS6/dl2/d1/L2dJQSEvUU3QS9ZQnB3LzZfTj. Last accessed 13th OCT 2014.

²⁹³ Regulating Procedures for Resolution of Securities Disputes - Capital Market Authority - Issued by the Board of the Capital Market Authority Under resolution No. (1-4-2011) , pursuant to the Capital Market Law issued by the Royal Decree No. (M/30) dated 31/07/2003.

²⁹⁴ Tadawul. Articles of Association of the Saudi Stock market Company (2014).. Available: http://www.tadawul.com.sa/wps/portal!/ut/p/c1/04_SB8K8xLLM9MSSzPy8xBz9CP0os3g_A-ewIE8TIwMLj2AXA0_vQGNzY18Q1wAoH4kk7x4QZmrgaeITbBQc4GVs4GLEQHdwap6-n0d-bqp-QW5EOQDHSS6/dl2/d1/L2dJQSEvUU3QS9ZQnB3LzZfTj. Last accessed 13th OCT 2014.

²⁹⁵ Capital Market Authority. Capital Market Law.

²⁹⁶ *ibid.*

The last chapter specifies the penalties for violations related to securities and identifies the offenses and penalties entailed, whether these violations are related to the offering of securities or the secondary market, which relates to trading and information. This chapter outlines the role and powers of the Authority in this area and determines the relevant jurisdiction for disputes related to securities.²⁹⁷

This law contains ten chapters, each of which focuses on one aspect of the financial market, and the regulations contains 67 articles. Knowing that CMC which mentioned in the system, will be instead of the Ministerial Committee and (Oversight Committee), the working mechanisms and operation of currently law trading, will remain the same in the market. In addition, local banks will continue to act as intermediaries.²⁹⁸

2.6.2 The Capital Market Authority (CMA)

The Capital Market Authority is a regulatory and supervisory body that oversees the market. It has financial and administrative independence and reports directly to the Prime Minister, which was established in 2003 under the Capital Market Law (CML) to supervise and control the parties coming under its authority. The regime has granted broad powers and authority to this body so that it can perform its duties and functions and fully play its role. This body serves to organize and develop the financial market, issue regulations necessary to implement the provisions of the law, achieve appropriate justice and efficiency in issuing securities, and provide justice and full disclosure in companies to protect investor and securities dealers.

The Capital Market Law (CML) sets out the principal functions of the CMA. The CMA is entrusted with the following duties:²⁹⁹ Regulate and develop the capital market and promote appropriate standards and techniques for all sections and entities involved in Securities Trade Operations; Protect investor and the public from unfair and unsound practices involving fraud, deceit, cheating, manipulation, and inside information trading; Maintain fairness, efficiency, and transparency in transactions of securities; Develop appropriate measures to reduce risks pertaining to transactions of securities; Develop, regulate, and monitor the issuance of

²⁹⁷ *ibid.*

²⁹⁸ *ibid.*

²⁹⁹ Capital Market Law Chapter Two.

securities and under-trading transactions; Regulate and monitor the activities of entities working under CMA; and regulate and monitor full disclosure of information related to securities and issuers.

2.6.3 The Committees for Resolution of Securities Disputes (CRSD)

Committees for Resolution of Securities Disputes (CRSD) established under paragraph (a) of Article / 25 of the Capital Market Law issued by Royal Decree No. M / 30 in 2004, for the adjudication of disputes that fall within the scope of laws of the Capital market authority and its executive regulations , and classified as a first-degree court. In accordance with the CML, the Committee must consider directly in the complaint within a period not exceeding 14 days from the date of filing of the complaint to the CRSD. Also, According to Article II of the regulations of CRSD, prohibits the deposit of any complaint with the Commission, unless it is first deposited with the Capital Market Authority and before the lapse of 90 days from the date of the deposit.³⁰⁰

Since the Capital Market Law picks up numerous cases and provisions, the CRSD implements its jurisdictions to assessment lawsuits in accordance with such rules. The CRSD has jurisdiction to hear a broad range of disputes, in the following points:³⁰¹ To consider the grievance of decisions and actions made by the Capital Market Authority or the Saudi Stock market which is known as the administrative lawsuit; To review lawsuits arising between investor themselves relating to the CML and its implementing regulations, as well as CMA and the exchange market regulations, rules and instructions in terms of public and private actions, what is known as the civil lawsuit; To consider litigations filed by the CMA (as a general prosecutor) against violators of the CML and its implementing regulations, what is known as the (penal lawsuit).

The Saudi capital Market Law (2003) grant CRSD (Committee for the Resolution of Securities Disputes) powers to investigate and settle complaints and suits. Grant CRSD the power to issue subpoenas and necessary decisions to resolve the suit. Also, The Capital Market Law grant CRSD the power to impose sanctions moreover, it has the power to order the presentation of

³⁰⁰ Capital Market Law Article 25(E).

³⁰¹ Capital Market Law Article 25(D).

evidences and documents, and CRSD the power to issue a decision awarding damages. furthermore, Grant CRSD the power to issue a decision awarding damages. According to the law of the capital market, any investor in the Saudi stock market has the right to claiming lawsuit against an investor, whether an individual (natural person) or (legal entity), It can also have the right claiming lawsuit against those who violate the Capital Market Law and its implementing regulations; on the basis of paragraph (a) of Article fifty-seventh of the Capital Market Law.

2.6.3.1 Committee of Appeal

Appeals committee was established according to paragraph (g) of Article 25 of the Capital Market Law, and form of three members one of whom is a representative of the Panel of Experts and the second representative of the Ministry of Finance and the third representative of the Ministry of Commerce. The Committee may appeal in its sole discretion to dismiss a decision issued by CRSD or confirm those decisions or reconsider the complaint or lawsuit, moreover, the appeals committee's decisions are final.

It May appeal decisions that issued by CRSD of through appeals committee within 30 days from the date notified in accordance with paragraph (f) of Article 25 of the Rules read with Article 39 of the regulations of CRSD. In accordance with Article 45 of the regulations of CRSD, the decision of the Commission acquires peremptory; either lapse of the prescribed time limit for appeal, Or give all parties in the lawsuit convinced the decision, or the decision of the Appeals Committee to confirm the CRSD's decision or by refusing to consider the CRSD's decision, or a decision by the Appeals Committee the reconsider of the case again.³⁰²

2.6.4 Saudi Stock Market (SSM)

In 2007 a joint stock company established under the name "the Saudi Stock market (Tadawul)" and is the Web site of the Saudi stock market and carrying capacity systemic financial market, Implementation of Article XX of the Capital Market Law.³⁰³ "Tadawul" has set its vision of becoming an integrated financial market, offering a comprehensive and diversified financial services and compete on a global level, and her message is based on providing products and

³⁰² Resolution of Securities Disputes Proceedings Regulations 2011, Article 39.

³⁰³ Capital Market Law Article 20.

services for financial markets, with all the efficiency, effectiveness and excellence in order to achieve added value for all beneficiaries and participants in the market.

The company's share capital of 1.2 billion riyals, divided into 120 million shares fully owned by the Public Investment Fund, As the statute of the company states that are part of the company's shares for public subscription raised at a time determined by the extraordinary general meeting of the company. Also, Council of Saudi financial market management "Tadawul" of the nine members are appointed by the Council of Ministers and the nomination of the chairman of the Financial Market Authority and include membership of the Council of representatives of the Ministry of Finance, and the Ministry of Commerce and Industry, the Saudi Foundation Arabian Monetary Agency, and four representatives of the licensed brokerage firms and representatives for contributing to listed companies.³⁰⁴

At a time when it is trying to achieve a number of objectives, including: Management and operation of the financial market efficiently, and provide high quality excellent services to ensure the management and operation of the financial market efficiently and effectively, Ensure efficiency, quality and fairness of the market, supporting efforts to raise the level of investment culture among investor efforts, providing excellent high quality services to customers, which include (brokers, investor, exporters, data service providers, and others. The company also is working to develop the potential and capabilities of technical and regulatory market by a leading financial market offers investment and financing channels competitive development through the provision of appropriate mechanisms for companies to obtain the necessary financing, Encourage both investor and exporters and local and international mediators to participate in the market.³⁰⁵

It is worthwhile to mention that Tadawul company has sought since its inception to the latest electronic trading systems application, in the following section will provide the historical stages of the development of electronic trading in the Saudi stock market, and the latest electronic trading system that has been applied on the Saudi stock market.

³⁰⁴ 'Home' (2016) <<https://www.tadawul.com.sa/wps/portal>> accessed 7 April 2017.

³⁰⁵ *ibid.*

2.6.5 Saudi Companies Act

The Companies Act can trace its roots to the Commercial Court Rules, issued by King Abdul Aziz in 1931³⁰⁶. The commercial court system adapted from the Ottoman laws, in turn, is derived from the French group issued in 1807³⁰⁷. This group is based on a set established by Louis XIV in 1773, which itself is a codification of customs and business practices that were prevalent in the Middle Ages. The Companies Act was a composite of 633 articles governing regulations on company activities. Most of the provisions of the Commercial Court were not sufficient and did not keep pace with the evolution and growth of companies in Saudi Arabia, many of the issues relating to such companies did not cover issues such as the liquidation of the company, merger with another company, and other matters relating to companies.³⁰⁸

Therefore, the Saudi Companies Law was promulgated by Royal Decree No. M/6 dated 22/03/1385 AH. It contains 233 articles that cover companies in the financial, commercial, industrial, agricultural, and service areas. This law includes general provisions, provisions relating to a company's statement of solidarity, simple recommendations, joint ventures, contributions, recommending shares, limited liability, cooperative companies, conversion and integration of companies, liquidation of companies, foreign companies, violations of sanctions regime, and a body for resolving commercial disputes.³⁰⁹

‘The Companies Act provides for the establishment of new joint-stock companies and the initial distribution of shares, which led to the Act becoming a cornerstone in the legislative framework of the Saudi Stock market. All provisions governing joint-stock companies are set forth in Articles 48 to 148 of the Saudi Companies Act’.

³⁰⁶ Commercial Court Regulations was issued under Royal Decree No. 32, dated 15/1350.

³⁰⁷ “A. Al-Kannas, 'Islamic Influence in Saudi Company Law in Regulations to Corporate Finance and in Comparison with British Company Law', pp. 10-11. Al-Kannas suggests that Saudi Arabia did not adopt British law, in view of Britain's influence in the Gulf region in that time, because the common law came too late to influence the Islamic system. Furthermore, the idea of law being revealed through a series of cases seemed strange to people who were accustomed to using treaties. Finally, the major western commercial influence in the region, Britain, made the task more difficult by never translating the common law into Arabic”.

³⁰⁸ Ministry of Commerce, The Explanatory Memorandum to the Draft of the Companies Act (1992)P6.

³⁰⁹ Al-Bogomi, Sharek at Elmosahamah Fe Alnedaam Saudi, Joint-Stock Companies in the Saudi Law - Comparative Study with the Islamic Law (Umm Al-Qura University 1986).

2.6.6 New Companies Act

The current Companies Act was passed by Royal Decree in 1965. It is now almost 50 years old. Furthermore, changes have occurred, such as the rise in oil prices in 1973 and the accompanying development programs that covered all parts of the Kingdom of Saudi Arabia and included all aspects of life³¹⁰.

Therefore, various entities to whom the Companies Act applies, such as government departments, businessmen, economists, administrators, and experts, have demanded a new Companies Act that takes into account the many developments in companies that have been adopted by most states' systems. Therefore, there is a need to accelerate the formulation of a new Companies Act that applies to the various advancements in trade and investment market requirements, including all texts and acts that ensure a balance between the rights of investor and boards of directors.

Accordingly, the study and development of the current Companies Act was approved, and the new project was undertaken by the Ministry of Commerce and studied very carefully by a body of 1427 experts with the participation of all relevant authorities. A very sophisticated and modern version was developed so as to avoid the gaps in the current system, after the draft was subjected to several audits by the Ministry of Commerce and the Shura Council; however, it has not yet been officially released by the state.³¹¹

The new draft law for companies contains 240 articles divided in 12 chapters. It abolished 17 articles of the old law and introduced 21 new ones, bringing the total number of articles to 240. The most prominent of these amendments include the introduction of a control board for each joint-stock company, specialized supervision of a company's business, the entitlement to convene a general assembly, and the preparation of detailed financial statements.³¹²

The system also introduced a special chapter (holding companies) that granted the right to own

³¹⁰ Companies Act was issued under Royal Decree No. M/6, dated 23/3/1385 (1965).

Amended under Royal Decree Nos. M/05 on 12/2/1387, M/23 on 28/6/1402, M/46 on 04/1405, M/63 on 26/11/1407, M/22 on 30/7/1412, and 1417.

³¹¹ Badrani, 'The New Companies Act', Alriyadh (2011).

³¹² *ibid.*

patents, trademarks, and privileges. Cancelled joint ventures, which are not legally established, are not subject to publicity. The new system requires investor in joint-stock companies to pay 50% of the nominal value of the shares at the IPO, instead of 25% in the current system. The company's capital is divided into shares of equal value and is not fragmented, with the value being not less than 10 Riyal instead of 50 Riyal in the current system.³¹³

According to the draft law, the Capital Market Authority is authorized to supervise the contributions included in the financial market and control of companies, the issuance of rules governing their work, and the regulations of mergers. Without impacting the powers of the Saudi Arabian Monetary Agency (SAMA), according to the Banking Control Law and Law on Supervision of Cooperative Insurance Companies, the new draft system requires a cumulative voting method for selecting members of the board for corporate governance so that no shareholder may use the right to vote³¹⁴.

³¹³ *ibid.*

³¹⁴ *ibid.*

Chapter 3: The Saudi Stock Market Disclosure Regime

3.1 Introduction

The aim of this chapter is to examine the current system of disclosure in Saudi Arabia and to assess whether it is adequate for its intended purpose, which can be found in the Companies Act 1965, Listing Rules³¹⁵ and Corporate Governance regulations. The researcher shall question whether, in light of the limitations of the current approach, a new set of rules is necessary to facilitate the release of information required by investor. Finally, the existing framework will be analysed from the perspective of the protection of investor.

One of the main elements of the stock market is disclosure and transparency, which is considered to be an important requirement for the proper functioning of market forces. Consequently, information asymmetry may threaten the growth of the stock market and cause inefficiency. The stock market crash in Saudi Arabia at the beginning of 2006 highlighted the lack of transparency and disclosure.

Thus, “Black argues that the two key elements of investor protection are (1) disclosure of information about listed companies and (2) confidence that the company's insiders won't cheat investor out of the value of their investment through "self-dealing. Transactions or outright theft. If these essential prerequisites are achieved, strong capital market can develop”.³¹⁶

³¹⁵ The principles of mandatory disclosure and transparency listed under the Listing Rules, as well as the list of corporate governance, are concisely stated. This section contains clarification of the functions of the Board of Directors, an explanation of the plans and decisions made by the Board of Directors regarding future business, and an explanation of the differences between the results of the current operating year and the previous year (this explanation aims to clarify which accounting principles have been prescribed but not applied by the Saudi Organisation for Certified Public Accountants). The Listing Rules section also names the company's branches and headquarters as well as the main countries in which these branches operate. This section also lists commercial activities, states the number of Board of Directors meetings, and lists the names of the male participants in these meetings. See the Financial Accounting Standards, ‘Saudi Certified Public Accountants’ (2011).

³¹⁶ Black (n 6).

Consequently, transparency and disclosure is regarded as one of the main elements of an improved stock market regulations as expanded disclosure reduces information asymmetry and therefore reduces transaction costs in secondary markets, resulting in increased share liquidity. Share liquidity, as noted by Black³¹⁷, Levine and Zervos and others³¹⁸, is a primary factor in market development.

Moreover, Black proposes that the provision of credible information about the value of a company's business (and therefore a reduction of information asymmetry) is an essential prerequisite for strong public securities markets, and that strong public market can facilitate economic growth.³¹⁹

Fair disclosure is critical for protecting investor, because information disclosure is a key factor in their investment decisions. Therefore, disclosure regulations aim to accomplish a number of goals. This involves, *inter alia*, the protection of investor and the promotion of efficiency. Disclosure and transparency also help investor make decisions within their respective companies. Consequently, a study Bhat *and other*, found that an increase in disclosure and transparency helped improve the environment of a given company.³²⁰ Moreover, these decisions are fully informed and investor are completely aware of the operational and financial factors affecting their companies. On the other hand, disclosure and transparency help companies properly display their positions and prevent forgery and deception. These factors also increase the ability of the stock market to monitor the boards and executive departments of its participating companies.³²¹ One of the most important lessons learned from the Saudi stock market collapse of 2006 was the detrimental effect of weak disclosure and transparency standards in annual and periodic reports as mentioned in chapter Two.

³¹⁷ *ibid*.

³¹⁸ Levine and others (n 23).

³¹⁹ Black (n 6).

³²⁰ Bernard S Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2000) 48 UCLA L Rev 781.

³²⁰ Gregg A Jarrell, 'The Economic Effects of Federal Regulations of the Market for New Security Issues' (1981) 24 The Journal of Law and Economics P613.

³²¹ AC Fernando, *Corporate Governance: Principles, Policies and Practices* (Pearson Education India 2009).

3.2 The Concept of Disclosure and Transparency

Robert defined transparency as accounting disclosure³²² that goes beyond the principles of public acceptance, accounting standards, and legislative requirements in financial reports to provide investor with the information they need to make their decisions.³²³ Frank and Thomas defined transparency as external users having access to the same information as members of a company's management team, thus giving these external users the ability to control management.³²⁴ Ragab defined transparency as the disclosure of any inside information that affects stock prices.³²⁵

3.2.1 Determinants of Disclosure and Transparency

Robert determined several factors affecting disclosure and several determinants of transparency. These were as follows³²⁶: Robert mentioned (90) of financial and non-financial elements disclosed by large companies in their annual reports, as well as the amount of general information about the balance sheets, income statements, and statements of cash flows

³²² “There are different definitions of transparency and disclosure and each definition consider a different aspect of disclosure. For example Lee (2012) believes that disclosure and transparency refers to accurate and timely release of information about the business strategy, financial performance and corporate governance to the general public by a company. Gibbins, Richardson and Waterhouse (1990, 122) defined financial disclosure as any deliberate release of financial (and non-financial) information, whether numerical or qualitative, required or voluntary, or via formal or informal channels. Patel and Dallas 2002 believe that transparency is an important element of corporate governance and state that Good corporate governance includes a vigilant board of directors, timely and adequate disclosure of financial information, meaningful disclosure about the board and management process, and a transparent ownership structure identifying any conflicts of interests between managers, directors, shareholders, and other related parties.”³²²

³²³ Robert M Valletta, ‘Clear as Glass: Transparent Financial Reporting’ (2005) 59 Health Finance Manage P58.

³²⁴ Frank B Gigler and Thomas Hemmer, ‘On the Value of Transparency in Agencies with Renegotiation’ (2004) 42 Journal of Accounting Research P871.

³²⁵ Ahmed Ragab Abdul Malik, ‘The Role of Financial and Non-Financial Disclosure "over the Internet to Improve the Decisions of Investor Market Securities - Theoretical and Practical Study’ (2005) IV The scientific journal of the economy and trade P85.

³²⁶ Robert M Bushman and others, ‘What Determines Corporate Transparency?’ (2004) 42 (2) Journal of accounting research P207.

elements disclosed by the company; Moreover, The disclosure group on research and development; The movement of the company's corporate data, including: the identities of the company's managers, the rewards and benefits usually assigned to board members, the stock owned by managers and employees, the company's major shareholder, and the rate of property; Information regarding the operational and information regarding the company's financial analysis. Finally: The timing of the financial report's publication. Robert's study reported that the relationship between transparencies, legal and political systems, and legitimacy is tied to the limitations of transparency. The presence of these systems is necessary to achieve transparency, and in the case of financial reports these systems help create better levels of transparency.

3.2.2 Barriers of Disclosure and Transparency

There are many obstacles a company may face when trying to achieve transparency. Some of these obstacles are: A lack of incentives for managers to deal with the interests of shareholders. There should be incentives for managers to disclose information regarding the company's current and future performance to external parties.³²⁷ As the presence of these incentives for managers of companies has two potential effects.

The first effect of these incentives is that they encourage managers to choose the alternative that results in showing the external parties that the company's profits are high, if the bonuses and incentives are associated with increasing the company's profits. The second effect of these incentives is that they cause management members to disclose information openly, causing the administration to provide accurate information about their finances. According to Eldahrawi, the model achieves adequate security by not risking real disclosure; by obtaining a fixed salary, a member of management is not affected by the results of the economic unit.³²⁸

Some managers attempt to mislead third parties by only disclosing good news about their company, even though they know that there is also news that does not reflect well on the

³²⁷ Benjamin M Oviatt, 'Agency and Transaction Cost Perspectives on the Manager-Shareholder Relationship: Incentives for Congruent Interests' (1988) 13 Academy of Management Review P214.

³²⁸ Kamal al-Din Mustafa Eldahrawi, 'A Model for Managers Incentives to Encourage the Disclosure of the Accounting Optional', (1987) XXIV Journal of College of Commerce for Scientific Research P162.

company's finances. If an incentive program were in place, a manager who made this mistake would face a penalty; that is, something would be deducted from his or her total rewards. In addition to raising the value of the company's stock in the long term, an incentive program would also help neutralize conflict between managers and shareholders.³²⁹ Changing Saudi Arabian accounting standards may improve the regulations of disclosure and thereby decrease the possibility of recording managers' economic transactions, which may not be in the best interest of the shareholders. The second obstacle a company may face when attempting to achieve transparency is the competitive advantage companies gain when they do not practice transparency. Company executives often complain that transparency reduces their ability to compete, even though no research indicates or confirms this phenomenon.

It is unknown whether or not the relationship between disclosure and competitiveness is causal or merely correlative. The researcher believes that the expanded flow of information is an essential requirement for free-market economics. This flow of information facilitates transparency and encourages competition, which leads to the improvement of the work at hand. Without this flow of information, it would be impossible for companies to grow and survive within the competitive business environment. Though many corporations object that disclosure reduces their competitiveness in the market, it is the opinion of the researcher that this objection is based on individual interest rather than public interest. It also has to do with a lack of awareness about the meaning and importance of disclosure.³³⁰

The third obstacle to transparency is the balance between cost and revenue. Accounting information is not free, and being transparent usually costs money. This means that disclosure requires an accounting system that accounts for the standard balance between cost and revenue.³³¹

3.3 Theoretical Perspectives on Disclosure

The importance of disclosure is best understood in the context of the role and meaning of information in the stock market. The basic question is; what role does information play in a

³²⁹ Oviatt (n 323).

³³⁰ S Subramanian and V Nagi Reddy, 'Corporate Governance Disclosures and International Competitiveness: A Study of Indian Firms' (2012) 11 Asian Business & Management P195.

³³¹ Shahrokh M Saudagaran, International Accounting: A User Perspective (CCH 2009).

competitive market? Information plays a fundamental role in stock prices, and consequently underlines the importance of delivering investor with as much significant information as possible.

3.3.1 Asymmetry of Information

The term 'information asymmetry' refers to the fact that company managers are more knowledgeable than investor are regarding the status of the company.³³² The managers are able to access accurate information regarding the financial status and future value of the company. This information may either support or not support the company's qualification for an active role in the market. This information can also be used to create an attractive image of the company for investor.³³³ The company's ability can be expressed using the information about profits distributed to the investor and the state of the asymmetry of information distributed. Reflect on the state of uncertainty, so it can reflect the inefficient status of the information. The company's internal parties (including owners and administrators) are supposed to be more informed than others (external parties) regarding the status of the company.³³⁴

In his famous essay, 'The Market for Lemons', American economist George Akerlof³³⁵ explains the information asymmetry problem. He does so using the US auto market, which he argues is a failed market. A 'lemon' refers to something with an appearance that suggests a higher level of quality than the item actually has. People assume that every used car is likely a 'lemon', which leads to the prices of used cars usually being less than their true values.³³⁶

Akerlof conducted a study with eight individuals buying used cars. If one individual found a serious flaw in the car, this increased the attempts of the used car dealer to try to sell that car

³³² Paul M Healy and Krishna G Palepu, 'Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature' (2001) 31 *Journal of accounting and economics* P405.

³³³ Katrien Mortelmans, *Enhancing Work Resumption of Patients on Sub-Acute Sickness Absence: Intervening in Information Asymmetry Among Medical Stakeholders Involved in Disability Management in Belgium* (Leuven University Press 2006) vol P361.

³³⁴ James Bradfield, *Introduction to the Economics of Financial Market* (Oxford University Press 2007) P365.

³³⁵ George A Akerlof, 'The Market For "lemons": Quality Uncertainty and the Market Mechanism' [1970] *The quarterly journal of economics* P488.

³³⁶ *ibid.*

to get rid of it. This led to more pressure on car dealers to keep used car prices as low as possible. This led those who had used cars in excellent condition to not attempt to sell their cars, as these individuals knew they would not get the right price for their respective car. This is because people would assume the used car was of low quality and thus deserved a low price. This in turn caused the balance of the market to remain low.³³⁷

In a seller's market with high-quality cars, people want to sell their cars for prices that are appropriate for their cars and buyers are willing to purchase these cars for these prices. However, buyers are often unable to obtain the information that would tell them whether the car they are interested in is of high quality or is a 'lemon'. In this respect, the market has failed to provide an equal opportunity for fair exchange between sellers and buyers. This means that the higher the price the buyer is willing to pay, the higher the minimum price the seller is willing to accept. This means that the market is far from achieving efficiency and that it remains an invalid option for achieving the optimal allocation of economic resources. The reason for this inadequacy is the asymmetry of information being shared between either sides of the buyer–seller relationship. There is also a lack of incentives for each party to disclose the correct information to the other party. The solution is to create conditions that motivate the parties to disclose the correct information and to generate appropriate incentives for the exchange process.³³⁸

Several studies have been conducted on this topic, including Spence's³³⁹ study of the labour market. Asymmetric information studies have been applied to the financial structures of institutions by Pyle and Leland³⁴⁰ and Ross³⁴¹. Scott³⁴² identifies financial accounting and reporting as mechanisms to control information asymmetry problems. These mechanisms work

³³⁷ *ibid.*

³³⁸ *ibid.*

³³⁹ Andrew Michael Spence, *Market Signaling: Informational Transfer in Hiring and Related Screening Processes* (Harvard University 1974) vol 143.

³⁴⁰ Hayne E Leland and David H Pyle, 'Informational Asymmetries, Financial Structure, and Financial Intermediation' (1977) 32 *The Journal of Finance* P371.

³⁴¹ Stephen A Ross, 'Options and Efficiency' (1976) 90 *The Quarterly Journal of Economics* 75.

³⁴² William Robert Scott and others, *Financial Accounting Theory* (0, Prentice hall Upper Saddle River, NJ 1997) vol 2.

by converting inside information into outside information. According to Kothari³⁴³, 'the theoretical literature shows that both mandated and voluntary disclosures reduce information asymmetries among informed and uninformed market participants'. He suggests that reduced information asymmetry has desirable effects on the cost of capital and the volatility of security prices, which motivates regulators to strive for high-quality accounting standards.³⁴⁴

Healy and Palepu³⁴⁵ and Black³⁴⁶ discuss several well-known solutions to the information asymmetry problem such as contracts to provide full disclosure, the use of intermediaries to search for private information, and regulations that requires private information disclosure.

3.3.2 Agency Costs Theory

Jensen and Meckling³⁴⁷ suggest that an agency relationship can be seen as a contract between investor (the principal) and managers (the agent) in order to perform some service on their behalf which involves delegating some decision-making authority to the agent'.³⁴⁸

'Agency cost' refers to the cost that arises because of the conflict of interest between investor and campaign managers. Agency theory arises as a result of the separation of ownership of governance institutions. The most important requirement of an agency contract is that an agent performs their responsibilities to maximize the benefit of the owner. In exchange, the agent receives the appropriate payment.³⁴⁹

Managers have more information than investor regarding the status of the institution. Managers sometimes pay attention to the achievement of their personal goals rather than the achievement

³⁴³ SP Kothari and others, 'The Role of Financial Reporting in Reducing Financial Risks in the Market' in CONFERENCE SERIES-FEDERAL RESERVE BANK OF BOSTON (Citeseer 2000).

³⁴⁴ Abdulla Muzahem, 'An Empirical Analysis on the Practice and Determinants of Risk Disclosure in an Emerging Capital Market: The Case of United Arab Emirates' (University of Portsmouth 2011) PP10,12.

³⁴⁵ Healy and Palepu (n 328).

³⁴⁶ Black (n 6).

³⁴⁷ Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4), *Journal of financial economics* P305.

³⁴⁸ Muzahem (n 340).

³⁴⁹ Jensen and Meckling (n 343).

of the investors' objectives³⁵⁰. When this occurs, what is required is some sort of cost borne by the investor to achieve their goals. This is where a primary agency cost source comes in. This cost is borne by investor to ensure that they have some control over achieving their goals. In the case of a lower degree of protection for the investor (or if laws are lacking or not applied optimally), managers are able to use their skills to use the institution for their personal benefit (La Porta, Lopez-de-Silanes, Shleifer, & Vishny,).³⁵¹ Managers can acquire good reputations by distributing stock dividends to shareholders, who think this distribution is the result of ideal voltage for managers.

Studies have shown that managers do not hate the distribution of cash flows to investor in the form of stock dividends. When there are few investment opportunities, companies may also resort to borrowing to provide liquidity and improve the distribution of earnings per share.³⁵² Despite his conviction that spending does not provide any economic benefit to a company, Fama described spending as part of an optimal operating managers hold; thus, spending is one incentive for managers to work harder towards the creation of an economic surplus. Fama does not consider these costs to be part of the cost of owning a company until they exceed a certain level or coincide with the poor performance of that company. Thus, Fama's views are not consistent with those of Jensen and Meckling³⁵³, who describe this spending as unethical behaviour and therefore consider it to be part of the cost of the company.³⁵⁴

According to Jensen the cost of sharing company information is worth more than the financial situation of the company.³⁵⁵ There remains an inability of stock market dealers to obtain adequate information to rationalise their investment decisions. This may be because of the

³⁵⁰ Michael C Jensen, 'Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers' (1986) 76 *The American economic review* P323.

³⁵¹ Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 *The journal of finance* P737.

³⁵² Michael S Long and others, 'An Empirical Examination of Dividend Policy Following Debt Issues' (1994) 29 *Journal of Financial and Quantitative Analysis* 131.

³⁵³ Jensen and Meckling (n 343).

³⁵⁴ Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of political economy* P288.

³⁵⁵ Jensen and Meckling (n 343).

limited information distributed from financial reporting, or it may be because managers pave the income methods and have an effect on the adequacy of disclosure.³⁵⁶

3.3.3 Signal Theory

Signal theory is a special type of asymmetry of information that occurs between the internal and external parties of a company. Signal theory occurs when administration members know more than other parties do about the quality of the institution. It also occurs when those parties use the production and reporting of information for their own benefit, or when administration members use reporting of information for their own benefit. This leads to higher costs resulting from the signals provided by the administration to external parties.³⁵⁷

The signalling process depends on the financial structure of signalling mainly through the borrowing and acquiring of an equity ratio through the company's administration. It works as a system used for providing important information to creditors and future shareholders, thereby reducing the level of asymmetry of information between dealers.³⁵⁸ Institutions that use false signals may acquire profits, but the sanctions and the potential risks of this activity are greater than the revenues. A company's level of debt can be used as a tool for signalling to ensure that signalling is used only by high-quality institutions. This means there is a positive relationship between the quality of a company's enterprise and its level of borrowing.³⁵⁹

3.4 Regulatory Framework for Disclosure in the Saudi Stock Market

The analysis of the previous section recommends that an information asymmetry between investor and the market is best reduced by a system of truthful disclosure, where stock market investor rely on the availability of accurate information to make quick decisions. As such, these investor favour regulations that governs capital market by applying the principles of

³⁵⁶ Michael C Jensen, 'Agency Costs of Overvalued Equity' (2005) 34 Financial management 5.

³⁵⁷ Michael Spence, 'Job Market Signaling' (1973) 87 The quarterly journal of Economics P355.

³⁵⁸ Stephen A Ross, 'The Determination of Financial Structure: The Incentive-Signalling Approach' [1977] 8(1), The bell journal of economics P23.

³⁵⁹ Bill Rees, Financial Analysis (2nd Edition, Financial Times 1995).

transparency and disclosure to determine the content and scope of application.³⁶⁰ In this section to assess the pattern of the disclosure regime in Saudi Arabia whether or not these regulations will help to protect the investor. Which can be found in the Companies Act 1965, Listing Rules³⁶¹ and Corporate Governance regulations. Such regulations have been released by the Capital Market Authority. This regulations includes a set of rules, regulations, and procedures issued by the Commission for applying provisions to the stock market law, including Listing Rules and Corporate Governance regulations.³⁶²

Bushman, Piotroski, and Smith they identify three mechanisms of overall corporate transparency: corporate reporting, private information acquisition, communication and information dissemination.³⁶³ The Capital Market Authority is working to raise the level of disclosure and transparency in the stock market and ensure justice among investor by ensuring the commitment of listed companies to disclose significant developments, and the underlying events, and to ensure that financial reports are accurate. This must be done in a timely manner and without delay in order to allow investor to make investment decisions in accordance with accurate and reliable information from the company. For the CMA to ensure justice, efficiency,

³⁶⁰ Jarrell (n 316).

³⁶¹ The principles of mandatory disclosure and transparency listed under the Listing Rules, as well as the list of corporate governance, are concisely stated. This section contains clarification of the functions of the Board of Directors, an explanation of the plans and decisions made by the Board of Directors regarding future business, and an explanation of the differences between the results of the current operating year and the previous year (this explanation aims to clarify which accounting principles have been prescribed but not applied by the Saudi Organisation for Certified Public Accountants). The Listing Rules section also names the company's branches and headquarters as well as the main countries in which these branches operate. This section also lists commercial activities, states the number of Board of Directors meetings, and lists the names of the male participants in these meetings. See the Financial Accounting Standards (n 311).

³⁶² This case can be classified a commentary on the Regulations of the Saudi Capital Market which refer to each other in comparison to other such markets. such as Regulations of the financial market in the United Kingdom. More specifically, a list of corporate governances issued, such as the British Financial Services Authority refer to the mandatory criteria of Listing Rules. Such as “DTR 7.2.2 R requires that the corporate governance statements must contain a reference to the corporate governance code to which the company is subject (for companies with a Premium listing this is the Code). DTR 7.2.3 R requires that, to the extent that it departs from that code, the company must explain which parts of the code it departs from and the reasons for doing so. DTR 7.2.4 G states that compliance with LR 9.8.6 R (6) (the “comply or explain” rule in relation to the Code) will also satisfy these requirements”. See ‘UK Corporate Governance Code’ (2014) <<https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>> accessed 8 April 2017.

³⁶³ Bushman and others (n 322).

and transparency in securities transactions, and to ensure that information is provided to investor in the stock market fairly and equally³⁶⁴, it developed the Listing Rules, which include the complete obligations of listed companies.³⁶⁵

3.4.1 Disclosure of Company's Future Plans

There is a significant importance attached to the disclosure of the company's future plans, as this increases the value of any strategic plans for investment and allows this to be used as an important source for decision-making (investor). It is no longer acceptable that investor within the stock market are limited to historical or current information only; indeed, the required information goes beyond current to the future, making it imperative for investor to study and understand the future prospects in order to speculate and think about the consequences of the decisions and actions in the future.³⁶⁶

For example, a report emanating from the US Congressional Committee, which investigated the causes of the collapse of Enron Corporation, pointed out that one of the main reasons for this collapse was due to the lack of disclosure of mutual operations between this company and its investment companies.³⁶⁷ From the financial studies angle transparency means providing information for the purpose of protecting the future of the investor, and to allow the community to recognize that the company is able to fulfil its obligations.³⁶⁸

³⁶⁴ These Regulations stress the need for an independent body or association of investor for companies listed in the Saudi market. Such an association would exist to ensure the rights of investor were upheld and to represent the investor in meetings. This association would also encourage disclosure and rational decision-making by companies. This would be a general association for all companies listed on the stock market. The main goal of this association would be to increase communication between the dealers and the boardrooms of the listed companies. It would also aim to work with the Capital Market Authority to determine the ideal financial practices for the boards of directors to follow in their financial statement reports, creating a more prudent system with greater protection for investors.

³⁶⁵ Ibid.

³⁶⁶ Baruch Lev, 'Information Disclosure Strategy' (1992) 34 California Management Review P9.

³⁶⁷ Alkhafaji, 'Corporate Governance and Today's Financial Scandals' (2003) 6 Business Research Year Book Global Business Perspective PP282,302.

³⁶⁸ Japan Committee, 'Corporate Governance Forum: Revised Corporate Governance Principles' (2001). Available: http://www.ecgi.org/codes/documents/revised_corporate_governance_principles.pdf. Last accessed 02th Apr 2015.

The Saudi stock market currently has 180 companies listed.³⁶⁹ The Saudi market does not disclose the plans and investments of most of its companies; currently, only four companies share some of their information on a monthly basis (Savola Group³⁷⁰, Cisco³⁷¹, ZOUJAJ³⁷², SRMG³⁷³) while others share information on a quarterly basis.³⁷⁴ That being said, the reports issued by these companies or consulting firms are always accurate and always use precise numbers from which stockholders can accurately judge whether or not to invest.

Moreover, the regulations regarding disclosure is in the Listing Rules. According to these rules, companies and their boards of directors must annually disclose their plans and investments in the form of annual reports. Companies may still remain committed to disclosing the minimum level of information; however, providing information without specific details does not tend to increase investment.³⁷⁵ Some companies issue their reports during the third or fourth quarter of the year. Investment channels work based on new production lines. There is often speculation regarding the shares of these companies based on what is stated in these reports. Many companies usually happen to hear such speculation, which indicates that though transparency legislation exists, enforcement of this legislation is relatively minimal.

However, disclosure regulations exists and is applied and that transparency will increase in the event of an expansion. Such an expansion would influence the investment decisions of management members or stock traders and protect the investor, as there would be a higher demand for companies to disclose their investments and investment plans. Alternatively, this

³⁶⁹ ‘Symbols Traded Tadawul’ (2015) <<https://www.google.com/search?q=+Symbols+Traded&ie=utf-8&oe=utf-8&client=firefox-b#safe=strict&q=Symbols+Traded+Tadawul>> Accessed 8 April 2017.

³⁷⁰ Savola Group was established as a Saudi public joint stock company in 1979, The aim of the production and marketing of edible vegetable oils and margarine in the Kingdom, Group is now one of the most successful multi-international operations of food companies, and growth in the Arabian Gulf and the Middle East, North Africa and Central Asia.

³⁷¹ Saudi Industrial Services "Cisco" was founded in 1988 as a shareholding company transformed into a holding company recently, it has a capital of 680 million riyals.

³⁷² National Co. for Glass Industries (ZOUJAJ), a joint stock company in the field of industrial investment company, was founded in the city of Riyadh, Saudi Arabia, and is one of the largest companies invested in glass manufacturing in the Middle East. The company is listed on the Saudi stock market "trading".

³⁷³ Saudi Research and Marketing Group (SRMG) is a Saudi joint stock company registered in Riyadh

³⁷⁴ Thamer Al Saeed, ‘Disclosure’, Al Jazeera (2013) <<http://www.al-jazirah.com/2013/20130825/ec16.htm>> accessed 8 April 2016.

³⁷⁵ Article 43 of the Regulations of the Listing Rule.

type of expansion could create problems for companies that did not practice transparency.

3.4.2 Director Responsibilities

Annual reports always appear as a fixed item on the agenda for the annual meeting of the general assembly. This portion of the meeting addresses absolving the quittance of the assembly's board of director's members. The board discusses this item routinely so that it does not take up more than a few minutes of each meeting.³⁷⁶ However, in 1999 a study by the American Institute of Certified Public Accountants (AICPA) found that in order for transparency to be realised in published reports, these reports should include the following information:³⁷⁷

Financial and non-financial company information; The management team's analysis of the financial and non-financial company information; Projective reports and information; Information about the company's management and shareholders; Background information about the company. A good example of such a case is what happened in Mobily³⁷⁸ Telecom company which suffered from transparency and integrity; the company "polished" their financial statements to indicate that they had maximised their income or adopted a historical cost rather than indicating the true value of the company. Such tactics are not uncommon for the majority of Saudi joint-stock companies.³⁷⁹ Manipulation of the financial statements of

³⁷⁶ Companies Act, 71,72,73,74,75,76.

³⁷⁷ Mark S Beasley and others, *Fraudulent Financial Reporting: 1987-1997: An Analysis of US Public Companies: Research Report* (AICPA 1999).

³⁷⁸ Etihad Etisalat Company was founded in the history of December 14, 2004 as a shareholding company after winning a license a second mobile phone in Saudi Arabia with a capital of five billion Saudi riyals, with the participation of the Emirati side represented by Emirates Telecommunications Corporation 27% and 11% for Social Security and the rest to the general shareholders.

³⁷⁹ The Corporate Governance Regulations issued by the Capital Market Authority have helped to establish the principles of disclosure and transparency, including, for example, encouraging the use of modern technology (i.e., email and websites) to inform public investor of the company's position and to provide statements and periodic information about operational matters. The vast majority of joint-stock companies have become quite adequate at using modern communication technologies to display information and to develop the company's market. There is a disparity between large and small companies regarding the speed and accuracy of their annual reports. Large companies are generally more likely to complete their financial reporting and operational patrol early and to make these reports available to the public at an early and appropriate time. See Damian Hine and David Carson, *Innovative Methodologies in Enterprise Research* (Edward Elgar Publishing 2007). Based on Study that focused on the relationship between the timing of companies listed in the Saudi Stock Exchange, and the number

such companies may be motivated by many factors. These companies may want to hide their losses, inflate their profits, mislead their rivals, or circumvent taxes without the complicity of the investor and the other party.³⁸⁰

Mobily Telecom is one of the top five most influential companies in the Saudi stock market. Mobily asked traders to stop trading its shares on the stock market for the purpose of its audit committee meeting. They then came out of that meeting without results, and the company did not announce its third quarter results. On November 2nd, 2014, the Capital Market Authority ordered stock market traders to stop trading Mobily's shares. This was at the request of Mobily, as the company wanted to wait until the announcement of their primary financial statements for the financial period ending on September 30th, 2014, before allowing stock trading again.³⁸¹

Within three days of the end of this financial period, the financial statements of the company were released. The release of these statements coincided with the recognition and declaration of the existence of a large mistake made by the company in which the company's restricted revenue was not reflected in their financial statements.³⁸² This discrepancy necessitated a

of characteristics for these companies, during the period 2001- 2005. This study also investigated the effect of the establishment of the CMA on the timing of the announcement of financial reporting and found that the contributions and data from Saudi companies were announced more quickly, since the implementation of the CMA. The average duration of company's advertisements for annual financial information declined to 28 days, in 2005. The study also found that large companies announced information faster than small companies do, and high-debt companies take longer to announce financial information compared to companies with low debt. Companies that with positive news delivered news faster compared to companies with negative news, which were purposely delayed. The study also showed a difference in timing of announcements, according to the industry and the type of company. See Ali A, 'The Relationship between the Timing of the Announcement of Financial Information and the Characteristics of the Saudi Joint Stock Companies' (King Saud University Repository 2006).

³⁸⁰ James Wahlen and others, *Financial Reporting, Financial Statement Analysis and Valuation* (Nelson Education 2014).

³⁸¹ Argaam, 'Suspended Mobily Share Trading' (2014).

³⁸² A different situation similar to the Mobily scenario occurred with the Tesco Company in the London stock market. The main difference between the Mobily situation and the Tesco scenario was the reaction of the regulators. Tesco is a retail company, which operates supermarket and types of stores in many countries around the world, including countries in Asia, America, and Europe. Tesco's activity is most highly concentrated in Britain, where its total sales reached more than 70.9 billion pounds, the equivalent of 112.78 billion USD. In mid-2014, Tesco announced that there was a problem with their financial statements. Due to their increase in revenue, the company initially expected to write off the equivalent of 263 million pounds for that period and previous periods. However, some information leaks from the company's financials determined that the value of the 2014 write-off was actually 1.6

change in the company's financial statements for the previous financial year, which involved write-off revenues in excess of 6.28 billion SAR, as well as a write-off net profit of more than 1.7 billion SAR. The CAM then agreed to return to Mobily to stock trading. This was expected to close the stock for three consecutive sessions and to create lower proportions without any requests. It was also expected to settle the stock at approximately 60 SAR. At one point, the company's stock exceeded more than 4 billion SAR in a single session.³⁸³

The company amended its financial statements for the past periods, resulting in the removal of the equivalent of 1.35 billion SAR from the balance of the company's retained earnings. This means that the account now amounts to only 12.8 billion SAR. This explains the failure of the Board of Directors to keep the quarterly distribution of the company's profit policy (1.25 per share) and its inability to pay a total of 417 million SAR (only 3.3% of the total retained earnings). Mobily aimed to regain the confidence of their investor and to clarify that they still had money despite what had happened. They reassured the investor that their stock was still in the hands of an honest company and that their stock-still had a future of growth and success ahead. However, it seems that Mobily failed to convince the necessary financial institutions of their bright future, as the company was actually in debt by over 14 billion SAR. Mobily was

billion pounds. Moreover, more than eight company managers have been laid off within the company, including the Chief Financial Officer (CFO) of British operations. All employees responsible for the discrepancy problem were removed from the company's roster. These layoffs were conducted after the formation of a commission of inquiry led by independent external auditors (Deloitte and Frishvild) under the guidance and supervision of the Financial Conduct Authority (FCA) and the Financial Reporting Council (FRC). Following the failure of the Board of Directors to catch this mistake, members of the Audit Committee were responsible for finding who was responsible for this grave mistake. The complicity of senior officials in this discrepancy was evident, including the company's Chairman and junior staff members. The collusion of some of Tesco's suppliers was also discovered. Following discovery of this mistake, Tesco's CEO announced the existence of this imbalance and vowed to take all measures in favour of the investor to amend the error. However, the stock lost more than 50% of its market value during that period, falling from a value of 370 pounds to 160 pounds per stock. The CEO then announced to the company's investor that he would correct the errors that had occurred and that the company would emerge from the incident unharmed. It should be noted that there was a connection between the Mobily incident and the Tesco situation: the same company—PricewaterhouseCoopers (PwC)—served as the external auditor for both companies. See 'Tesco, What Went Wrong? - BBC News' (2014) <<http://www.bbc.co.uk/news/business-29716885>> accessed 8 April 2017.

³⁸³ Argam (n 377).

already facing the problem of liquidity in both the short and long term.³⁸⁴

The Chief Executive Officer (CEO) of Mobily acknowledged the real reason for the suspension of the company's stock, stating that ' On Wednesday we found that the stock had been frequently traded, so we suspended the stock to preserve information about the shares until such a time that our investor would have equal opportunities to use the information. This raises several questions: Who sold the shares, and why? How did this individual obtain the internal information, and in what capacity? Were the company's owners or their relatives responsible? Could one of the members of the board of directors have been responsible?'.³⁸⁵

A legal controversy exists regarding the importance of a quittance in terms of the responsibility of board members. However, this decision will not change the fact that transparency is now entrenched in the business laws of most of the world's countries. These laws require companies to take responsibility for the preparation of their financial statements, and they dictate that the company is the only party responsible for errors, fraud, or manipulation of those documents.³⁸⁶ Each company is also responsible for ensuring that it has an effective internal control system to help to reduce the likelihood of such abuses occurring.³⁸⁷

These business responsibilities³⁸⁸ have all been incorporated into US law (Sarbanes & Xola,)

³⁸⁴ 'Mobily" describes the Reason for the High Loss for 2014 and Confirms Its Ability to Meet All Its Financial Obligations Facility', Argam (2014) <<http://www.argam.com/article/articledetail/490125>> accessed 10 April 2015.

³⁸⁵ 'Chief Executive Officer of "Mobily" Khalid Al Kaf Interview with Channel "AL Arabiya', AL Arabiya (2014) <<http://www.alarabiya.net/ar/aswaq/companies/2014/11/03/.html>> accessed 10 April 2015.

³⁸⁶ Avshalom M Adam and Tal Shavit, 'Roles and Responsibilities of Boards of Directors Revisited in Reconciling Conflicting Stakeholders Interests While Maintaining Corporate Responsibility' (2009) 13 *Journal of Management & Governance* 281.

³⁸⁷ Companies Act, 77,78,79.

³⁸⁸ After a number of scandals and accounting major companies such as Tyco International, Enron, WorldCom issued, Adelphia and Peregrine System. especially After, Enron company was declared bankrupt by the US Bankruptcy Code. Prior to filing for bankruptcy, the company's assets were worth 63.4 billion USD. After this scandal, a new law was issued to protect the market and investor from future incidents of a similar nature (the Corporate and Auditing Accountability and Responsibility Act). US Congress also issued the SOX Act Law, which held CEOs, CFOs, and chartered accountants responsible for irresponsible or dishonest business decisions affecting stockholders. CEOs and CFOs were now directly legally responsible for any deliberate misstatements in their companies' financial statements. In conjunction with this law, the Securities Commission and the US stock market created

³⁸⁹ The creation of these laws were initiated by the bankruptcy of a number of giant corporations, much of which was caused by the failure of these companies' management teams to adequately disclose important information. Many other countries have also begun following this transparent approach to business laws.³⁹⁰

Accordingly study by Al-Bogami aimed to test the benefits of the initial financial reports for individual investor and institutions specializing in the Saudi stock market. The study used three methods to investigate: First, a review of disclosure practices regarding the initial financial reports consisting of a sample of 11 joint-stock companies in the period between 1987 and 1991. Second, a questionnaire was provided to individuals, specialized institutions specialized, and financial managers in the period from April to June 1994. Third, the response to the stock prices following the announcement of the initial financial reports was tested using the weekly stock prices of 39 joint-stock companies from 1-1-1987 to 15-6-1991. The study found that the initial financial reports used by investor in the Saudi stock market needed more standards and regulations to increase their use, as the experimental results showed that Saudi investor were using the third and fourth quarter reports, mainly to predict annual results.³⁹¹

This led to decision No. 2217 of the Minister of Trade, which was made on 25-03-2002. This decision required the managers of each joint-stock company to provide recognition demonstrating that the company's financial statements do not include any incorrect statements or information and that the company did not omit any data or information, which would be misleading if omitted.³⁹² This decision represents a major step for the role of preparers of financial statements for protecting investor; this decision is further defined in Article 76³⁹³ of

the Public Company Accounting Oversight Board (PCAOB) for chartered accountants. This council is tasked with overseeing the Regulations, inspection, and discipline of accounting firms.

³⁸⁹ US Securities and others, 'The Laws that Govern the Securities Industry' (2006) 29 Retrieved September 2006.

³⁹⁰ Similar laws in other countries C-SOX - Canadian equivalent of Sarbanes–Oxley Act and German Corporate Governance Code - 2002 German corporate governance code.

³⁹¹ Sultan AS Al-Bogami, 'An Examination of the Usefulness of Interim Financial Statements to Investor in the Saudi Stock Market' (University of Dundee 1996).

³⁹² 'Ministerial Decree No. (2217) Dated 01/11/1423 AH on Internal Surveillance in Joint Stock Companies' (2013).

³⁹³ Companies Act, "Article (76): Members of the Board of Directors shall be jointly responsible for damages sustained by the company, the stockholders, or third parties due to their maladministration of the affairs of the company, or their violation of the provisions of this Law or the company's bylaws.

the company Act. The General Assembly's annual meeting will rely mainly on this recognition. If a company's exclusion of information is discovered after the publication of their financial reports, the preparers of these financial statements will now be held responsible for any errors, fraud, or manipulation of these documents.

The greatest impact of this decision is that it confirms the responsibility the company's management has for its internal control system. The control system is considered to be the backbone any successful accounting unit; when the control system is, there is less likelihood for error. Control over a company's business belongs to the jurisdiction of the company's general assembly, as stipulated in Article 129³⁹⁴ of the company Act: 'Investor shall exercise control over the company's accounts'. Because this may be difficult to achieve, Article 130³⁹⁵ stipulates that a company may appoint an auditor to take charge of that task on their behalf if necessary.³⁹⁶

The Companies Act contains explicit provisions regarding the work of each company's board of directors. This includes the provisions of Article 68³⁹⁷, which dictates rules regarding providing verification of a member of the board of directors of the shares of security' in the date specified for that task, and including any violation of this type in its report to the general assembly. Article 69³⁹⁸ states the necessity for any member of the board of directors to inform the Council of matters regarding his personal business interests and how these might affect the company.

Any condition contrary to this provision shall be considered nonexistent. Liability shall be assumed by all members if a wrongful act arises from a resolution issued and adopted by them all. But with respect to resolutions adopted by majority vote, dissenting members shall not be liable if they have expressly recorded their objection in the minutes of the meeting. Absence from the meeting at which such resolution is adopted shall not constitute cause for relief from liability, unless it is established that the absentee was not aware of the resolution, or unable to object after becoming aware of it. The approval of the Ordinary General Assembly to exonerate the members from liability shall not be required when filing a liability claim. Such a claim shall not be heard after the lapse of 3 years from the date of disclosure of the harmful act."

³⁹⁴ Article (129): The investor monitor the accounts of the company in accordance with the provisions set forth in the company's Regulations and subject to the following provisions:

³⁹⁵ Companies Act, 130.

³⁹⁶ Ibid.

³⁹⁷ Companies Act, 68.

³⁹⁸ Companies Act, 69.

This high level of efficiency is usually due to a contract obligation to auditors and accountants. It is also sometimes due to the high internal audit quality of these companies. Article IV³⁹⁹ of the indicative list of corporate governance states that a company's contract should specify the supervisory role of the company's disclosure and transparency applications.⁴⁰⁰ Moreover, according to the list criteria of the Listing Rules, disclosure and transparency standards are legally binding. Article IX⁴⁰¹ of the Corporate Governance regulations stipulates a few disclosure and transparency standards. Regulations for shareholding companies, including mandatory standards for disclosure and transparency, are mentioned in the Listing Rules.⁴⁰²

The Chairman of the board of directors shall inform the company's general assembly of any business or contracts that may be of personal interest to one of the members of the board of directors. Attached to this report is a special report from the auditor. According to the content of Article 131⁴⁰³, the auditor has the right to review the company's books, records, and documents. Article 132⁴⁰⁴ requires the auditor to submit the annual report of the general assembly. The auditor should be guaranteed by the company's management that he will be able to complete his work with no hindrances. If violations of the company's rules or system are discovered, the auditor has the right to state the facts regarding these issues with the company's accounts.⁴⁰⁵

³⁹⁹ "Article 4: Facilitation of Investor Exercise of Rights and Access to Information

(a) The company in its Articles of Association and by-laws shall specify the procedures and precautions that are necessary for the shareholders' exercise of all their lawful rights.

(b) All information which enable investor to properly exercise their rights shall be made available and such information shall be comprehensive and accurate; it must be provided and updated regularly and within the prescribed times; the company shall use the most effective means in communicating with shareholders. No discrepancy shall be exercised with respect to investor in relation to providing information."

⁴⁰⁰ Article IV OF Corporate Governance Regulations .

⁴⁰¹ "Article 92: Disclosure in the Board of Directors' Report In addition to what is required in the Listing Rules in connection with the content of the report of the Board of Directors, which is appended to the annual financial statements of the company, such report shall include ...etc."

⁴⁰² Article IX OF Corporate Governance Regulations .

⁴⁰³ Companies Act, 131.

⁴⁰⁴ Companies Act, 132.

⁴⁰⁵ Michael B Adams, 'Agency Theory and the Internal Audit' (1994) 9 Managerial Auditing Journal 8.

Article 76⁴⁰⁶ of the Companies Act states that any members of a company's board of directors asking about the damage that arises from the mismanagement of the company's affairs is in violation of the Companies Act.

There is a proven method for effectively choosing review board members and determining the ideal duration of their membership and methods of work. The Commission is based on the board of directors; this creates a fundamental defect in the control of the companies, as it makes the Council of company both the adversary and sentence at the same time. Additionally, the Audit Committee is entrusted with monitoring the company's accounts in conjunction with the company's chartered accountant and also with ensuring the company acts in accordance with the provisions of Article 123.⁴⁰⁷

3.4.3 Who Should Bear Fines?

The CMA announced ten resolutions, these resolutions regarding the imposition of 'varying fines' on some of the stock market's companies.⁴⁰⁸ The previous disclosure of information was either delayed or inaccurate for these companies. This can be seen as a continuation of the approach the CMA has taken with the fining of such companies. However, the real cause of error for these companies was poor management. These delays in disclosure affected investor while secretly benefitting people who had access to the information before it was made public.

Since the establishment of the Authority, everyone has been convinced that the application of these fines is unfair to investor. However, the Authority still ignores the real offender in the imposition of a fine, so the CAM bears the responsibility to the owners of the company. Beyond the size of the fines to each company and their impact on profits, the principal goal of the legislature—during the preparation of the CAM and the rules and regulations governing the financial market—was to enable the CAM to impose fines to ensure the commitment of all the departments in the companies to the regulations and rules, particularly with respect to disclosure and transparency, in order to provide a healthy environment for the stock market

⁴⁰⁶ Companies Act, 76.

⁴⁰⁷ Companies Act, 123.

⁴⁰⁸ Abdulrahman Alkhareef, 'The CAM's Fines Remain on Those Affected', Al-Riyadh newspaper (2014) <<http://www.alriyadh.com/952255>> accessed 21 April 2016.

rather than for the purpose of raising CAM revenue.⁴⁰⁹

Therefore, the objective of the fine should be to evaluate and correct administrative errors and ensure that they do not recur for protecting investor, and the achievement of these objectives requires agreement regarding the decisions on the fines. Therefore, CAM continuing to impose fines on the companies will not achieve the goal, and the resulting delay in disclosure is still far from bearing consequences. If a company pays the fine and considers it part of its annual expenses, the company can benefit from the delay of the announcement by using inside information in the speculative market, which is clearly seen in the trading companies that rise or fall in the proportions, and the reason is revealed after the market closes or days after. Following the damage to the company's shareholders, the CAM also punishes them by fining their company.

Therefore, the CAM should reconsider its decisions regarding fines, even if this forces it to modify or add material to the Listing Rules so that it is the general manager or CEO that primarily bear the full fines because of errors or delays, along with the Board of Directors, as it is the administrative and supervisory authority for the executive management. Because high salaries and bonuses are paid to officials and members of the Board, this must be matched in terms of responsibilities, and they must be providing transparent and clear justifications for the fines, especially if some of them were for delays in the declaration of information that is no longer important to investor.⁴¹⁰

One example would be the delayed Allianz Insurance company announcement after the close of trading in 2-1-2014, whereas, Monetary Agency's decision that approved the renewal of the permit to practice certain insurance activities was received in 1-1-2014, which means it was only a delay of one day. While the company's share rose a week from the date of approval and benefited from speculators, the CAM and the rest of the investor did not know why, which means that CAM needs to identify the real offender in hiding information and not rely on the dates of the letters. In addition to the frequent and strange errors in the News "quarterly results," and without punishing the offender.⁴¹¹ Corporate commitment to transparency requires a

⁴⁰⁹ *ibid.*

⁴¹⁰ Martin J Conyon and Simon I Peck, 'Board Control, Remuneration Committees, and Top Management Compensation' (1998) 41 *Academy of Management Journal* P146.

⁴¹¹ "The Capital Market Authority announces the issuance of a CMA Board resolution to impose a

greater understanding of the CAM and the application of the market regulations, which ensures that the one who breaches market regulations will bear the responsibility.⁴¹²

It is worth mentioning that, it is important that the disclosure and transparency guidelines dictated by the Saudi Capital Market Authority remain sufficient as guidelines for the implementation and compliance of listed companies in the Saudi market. Sometimes it is even necessary for the Council of the CMA to punish companies who do not comply with one or more of the principles of disclosure and are punishing this or that company financial fine and defamation. For example, there tend to be some irregularities in governance conventions. Such issues might include conflicts of interest and internal trafficking by members of the board of directors. Moreover, some companies are punished by the CMA to the management of firm according to breach on more than one principle of disclosure. If a company breaches such a principle more than once, they may be having to pay a fine of 50,000 to 100,000 (SAR).⁴¹³ They may also be formally charged with defamation. The legal principles inherent to disclosure rules require severe punishment in the case of repeated violations, as is mentioned in the Listing Rules and corporate governance regulations. This is different for investor, who make investment decisions based on a company's financial statements.⁴¹⁴ These statements are supposed to exercise absolute integrity and transparency.

3.4.4 Disclosure of Material Information

IOSCO argues that the most significant methods for ensuring investor protection, which are considered to be one of the main elements in the development of stock market, is to require the full disclosure of information material to inform investors' decisions.⁴¹⁵ When talking about

penalty of SR 10,000 (Ten Thousand Saudi Riyals) on Allianz Saudi Fransi Cooperative Insurance Company, due to its violation of clause (A) of Article (46) of the Capital Market Law and clause (A) of Article (41) of the Listing Rules. The company failed to inform CMA and the public about obtaining a permit renewal of SAMA on 01.01.2014 AD, to practice insurance activity in the following sections (general insurance, health insurance, protection and savings). It was later announced on 02/ 01/2014 AD after the market was closed". See http://cma.gov.sa/en/News/Pages/CMA_N_1490.aspx.

⁴¹² Alkhareef (n 404).

⁴¹³ 'Saudi Stock Market Regulator Fines Seven Companies for Disclosure Violations | The National' (2014) <<http://www.thenational.ae/business/markets/saudi-stock-market-regulator-fines-seven-companies-for-disclosure-violations>> accessed 14 April 2017.

⁴¹⁴ H Kent Baker and John A Haslem, 'Information Needs of Individual Investors' [2015]P66.

⁴¹⁵ IOSCO Multilateral MOU, IOSCO (May 2002).

the CMA, we are talking about a government sector, but it is not traditionally a sector with a lot of the monotonous bureaucracy that might be expected in a government sector according to traditional thinking. Considering the CMA laws and its regulations, it is important to note that relatively the CMA stopped reviewing and developing these regulations, as there were criticisms that resulted in the need for short, non-detailed laws. This is acceptable given that the Saudi market is an emerging market, and companies listed in the market were not familiar with detailed and sophisticated laws. However, the companies have now gained a lot of experience, so it is a good time to provide more efficient and sophisticated regulations.⁴¹⁶

The shortcut in the regulations led to a lot of uncertainty and a lack of clarity with regard to the instructions. It was necessary, as with developed countries, for a draft of the regulations to be written and published to the public so that it could be discussed and studied by the bulk of specialists, including workshops and seminars, to ensure better regulations. For example, on the subject of disclosure, which is a very important and very broad subject, it has been found that the most important information on this subject can be found in Chapter VII of Capital Market Law articles 40–48⁴¹⁷ and articles 25–39⁴¹⁸ of the Listing Rules, as well as Article IX⁴¹⁹—which became obligatory—from the list of Saudi corporate governance. While disclosure and transparency were detailed in the rules, this does not mean that all obligations, with respect to this section, exist in this legislation. For example, the laws and regulations of the British market authority (the UK Listing Authority or UKLA) can be found in seven chapters (129 pages).⁴²⁰ This is undoubtedly not an accurate benchmark for comparison, but it does show the extent of the shortcut with respect to the obligations of disclosure in the Saudi stock market.

⁴¹⁶ Carol Ann Frost and others, ‘Stock market Disclosure and Market Development: An Analysis of 50 International Exchanges’ (2006) 44 *Journal of accounting research* P437.

⁴¹⁷ Capital Market Law Chapter VII Articles 40–48.

⁴¹⁸ Listing Rules Articles 25–39.

⁴¹⁹ Corporate Governance Regulations Article IX.

⁴²⁰ ‘FCA Handbook - FCA Handbook’ (2015) <<https://www.handbook.fca.org.uk/handbook/DTR/>> accessed 8 April 2017.

One of the points that needs to be clarified in this section is that article 46⁴²¹ refers to the requirement to disclose when any significant change from the source. This term (which is essential) is often repeated in the regulations, and many commitments are developed based on it, but this term it is not defined in the first article, which provides the definitions of terms, nor in the list of terms issued by the CAM. There is a reference to a similar term in the Listing Rules issued by the CMA in article 25.⁴²² It provides only an explanation and an example, and it may be appropriate to refer some notes on this important article.⁴²³

Among the criticisms of this article; linking these “significant change” of what can happen to change the price of shares, although it may occur without an important development. Similarly, there may be an important development that does not change the price of securities on the market. This is not an accurate criterion, and should perhaps be linked to developments that lead to a change in earnings or book value, for example, or other aspects that are more accurate and disciplined.

Mentioned in the same article, paragraph (b/4),⁴²⁴ is another criticism, where the regulations pointed to one example amid nine examples on how the source must disclose anything as soon as it happens. This example refers to ‘any significant change in the source production environment or trade, for example the availability of resources and accessibility’. This statement is not enough to be clear commitments. For example; in the case of high or low prices for products, should this development be entered as a change to the production environment? With regard to the practice of companies in the market, this is generally not a commitment. For example, some petrochemical companies’ profits rise by close to 100% based on the high prices of products, but this development is not disclosed.⁴²⁵

⁴²¹ "Article 46: Notification Related to Securities (a) An issuer must notify the Authority without delay of any significant change in the holding or identity of those persons holding more than 5% of the issuer's shares or convertible debt instruments".

⁴²² Article 25 OF Listing Rules.

⁴²³ *ibid.*

⁴²⁴ "(b) An issuer must notify the Authority and the public without delay of the following information: 4) any decision to call, repurchase, draw, redeem or propose to buy any of its securities and the total amount and value thereof".

⁴²⁵ 'CMA: Listed Company Required to Inform Public About Any Material Developments That Are Not Public Knowledge' (2015) <<https://cma.org.sa/En/MediaCenter/pk/Pages/Disclosure-Awareness-Report-English.aspx>> accessed 8 April 2017.

Moreover, paragraph b/7⁴²⁶ in the same article: ‘increase and decrease in the total sales of the source, including equal to or more than 10%’. For example, it has been found that banks often do not disclose the number of branches that have been opened in the quarter. With these branches, it could collectively raise the total sales (or processes with regard to banks) by 10%, especially for emerging banks, where opening one branch could change the total sales. Hence, there is a question regarding the ambiguity of this paragraph, and it may be insufficient with regard to achieving transparency.

There is a single article regarding exemption from the disclosure, which is Article 18 of the Listing Rules,⁴²⁷ and it does not mention that if the firm see that the issue of the disclosure will lead to damage or misleading, so it is eligible to apply for the exemption. While the British rules that were referred to earlier separated and showed detailed controls for cases where non-disclosure or delayed disclosure were accepted, and the conditions for doing so, and then dispersed between the internal information that accept the delay, which does not accept.

3.4.5 Rumours and Duty of Disclosure

Rumours are the scourge of investment within financial market. However, eliminating them is highly problematic because for some they constitute a hidden weapon for seeking advantageous information. Thus, investor should be protected from rumors that are published in newspapers that can misinform their investment decision.⁴²⁸ The Saudi securities market has wrestled with rumour difficulties, using disclosure and transparency rules in an attempt to eliminate them. The market has had some success by urging the timely publication of information by listed companies. However despite this limited success, rumours continue to impact the market for small investor.⁴²⁹

Stock market must be protected from incorrect news or information. The rate at which news

⁴²⁶ *ibid.*

⁴²⁷ *ibid.*

⁴²⁸ Fábio Marques da Cruz and others, ‘The Influence of Rumors in the Stock Market: A Case Study with Petrobras’ (2013) 25 *Transinformação* 187.

⁴²⁹ Mark Schindler, *Rumors in Financial Markets: Insights into Behavioral Finance* (John Wiley & Sons 2007) vol 413.

and information is confirmed or denied, in particular news related to new company inclusion or listed companies in the market, can greatly impact market activities. The spread of news without Capital Market Authority of Saudi Arabia (CMA) confirmation or denial creates uncertainty for investor looking to this kind of information to guide investment decisions.⁴³⁰ However, there is an important aspect that is not touched on in stock market regulations, which is how to deal with rumours that circulate in the market. This is detailed clearly in the British legislation, and in this case it mentioned the duty of exporters.⁴³¹

On 31 March, 2016, the CMA published amendments to part 8, article 40, paragraph (e) of the CMA Listing Rules stating that "an issuer must determine the need to publish an announcement to the public in response to rumours related to any material development, and the CAM may require such publication to be made by the issuer as it sees appropriate." CMA listed companies must therefore carefully adhere to these new instructions relating to news announcements and substantive events that have occurred or are expected to occur, including the publication on the Saudi stock market site <https://www.tadawul.com.sa>. Based on the above, listed companies are obliged to disclose and to respond to rumours regarding any material developments.

Investor behavior is very important in the Saudi stock market. The credibility of the source of market information obtained by investor relating to existing companies or companies under establishment must be determined because of the significant impact it can have on investor. Within the market there are investor and rumour mongers looking to use information at the expense of small investor. The role of the CMA within the market is to provide important information about listed company shares and disseminate information to investor through its Web site and oblige companies published in the daily newspapers. However, some investor instead bases their investment decisions on the comments and views of non-authorized persons. This can not only hurt their investments, but also can detrimentally affect the market by generating random, unnecessary increases or drops in share prices.⁴³²

⁴³⁰ John M Sheffey, 'Securities Law Responsibilities of Issuers to Respond to Rumors and Other Publicity: Reexamination of a Continuing Problem' (1981) 57 Notre Dame Law P755.

⁴³¹ Cruz and others (n 424).

⁴³² Under DTR 2.7 the issuer has an obligation to take right action if there is press speculation and rumours.

3.4.6 Disclosure of Directors' Remuneration

The controversial issue of board of directors' remuneration remains a thorny issue, and is linked to the more complex problem of conflicts of interests.⁴³³ It is the job of members of boards of directors to make decisions and plan strategy for the deployment of company resources in order to achieve the company's stated goals and objectives regardless of their own personal interests. Among the most important of these objectives is the goal of generating profits commensurate with the volume of investment.⁴³⁴

However, it can be difficult to assure that board members are willing to subjugate their own interests to those of shareholders, a situation relevant to some market failures that have followed major financial collapses. It can be problematic to guarantee that a group of self-interested individuals will make decisions for the benefit of a large number of unknown investor.⁴³⁵ It is a global phenomenon that daily changes to stock ownership positions can compromise the moral and ethical conduct of some who sit on boards of directors. The possibility exists that boards of directors' members may take steps to amplify personal benefits by inflating bonuses. Investor must therefore be protected against any use of coding systems that obfuscates director remuneration methods. Remuneration must be clearly identified through transparent disclosure.⁴³⁶

The Saudi Companies Law has not ignored this important issue since its release nearly 50 years ago. The method for determining directors' remuneration is listed in article 74, stating that the directors' remuneration must not exceed 10% of the net profits of the issuer after deduction of expenses, depreciations, and such reserves as are determined by the general meeting or by the issuer's by laws, and after distribution of a dividend of not less than 5% of the issuer's capital to the shareholders.⁴³⁷

Despite article 74, data on bonuses to Saudi companies' board members shows that 17

⁴³³ Robert N Clarke and others, 'Corporate Governance and Directors' Remuneration: Views from the Top' (1998) 9 Business Strategy Review 21.

⁴³⁴ Alexander Kostyuk and others, *The Theory and Practice of Directors' Remuneration: New Challenges and Opportunities* (Emerald Group Publishing Limited 2016) P232.

⁴³⁵ Clarke and others (n 429).

⁴³⁶ Zabihollah Rezaee, *Corporate Governance and Ethics* (John Wiley & Sons 2009) P69.

⁴³⁷ Saudi company act Article 74.

companies listed on the Saudi market (out of a total of 169 companies as of 1 January, 2015) did not comply with the provisions of article 74. Board member remuneration for these organizations included annual bonuses for board members despite some losses generated in their previous year's work. For example, some companies, such as Al-Ahsa Development, recommended a bonus in excess of 10% of the company's net profit despite the fact that the company's board report confirms the policy of bonuses not to exceed 10%. Add to that the fact that none of the companies covered by the list distributed any cash dividends to investor even though cash dividends are a required prerequisite to board member bonuses.⁴³⁸

In Article 74 of the of Saudi Companies Law, the legislature determined that directors' remuneration is to be establishment as part of contract negotiations between the company and the director. The only requirement imposed by the Saudi Companies Law is that remuneration not exceed 10% of the net profits of the issuer after deduction of expenses, depreciations, and such reserves as are determined by the general meeting or by the issuer's bylaws, and after distribution of a dividend of not less than 5% of the issuer's capital to the shareholders.⁴³⁹

However, within the new Companies Act, modifications were added with respect to board of directors' remuneration. Controls have been added specifying that remuneration must be fair and proportionate to the terms of reference of a member of the board of directors, the business responsibilities performed, and to the targets set by the board of directors for the fiscal year. Furthermore, a member of the board of directors may receive remuneration for membership in the general assembly's Audit Committee, or for any additional operational, technical, administrative or advisory positions assigned by the company.⁴⁴⁰

It is important to note that the disclosure of remuneration is not as important as the way in which it is identified, and here the legislative system intersects with the principles of corporate governance and the market system. All of these principles focus on the importance of the structure of boards of director's bonus issuance and disclosure in order to maintain a healthy economic and investment environment.

⁴³⁸ 'Directors' Remuneration', Argam (2010) <<http://gulf.argaam.com/article/articledetail/149298>> accessed 2 April 2015.

⁴³⁹ Article 74 of the of Saudi Companies Law.

⁴⁴⁰ 'directors' remuneration' (n 434).

3.4.7 Should Risks Be Disclosed?

Stock market are characterized by the relationship between risk and expected profits. However, if a certain market is described as being high risk, it does not mean that the risks are unknown or cannot be predicted *ex anti*. Business risks can be followed like a recipe, and skilled market analysts know they can be predicted well in advance.⁴⁴¹ Understanding the market equation allows professional managers to maintain investors' property and predict risk before it manifests. Disclosure is therefore crucial to facilitate communication between companies and current and future shareholders. Disclosure makes use of relevant studies and legislation, and develops transparency related to company risks.⁴⁴²

The term risk means the potential for a lack of clarity or potential uncertainty related to the likelihood of expected future market gain or loss. All companies are subject to risks, but the identification and classification of the importance of risk varies from one company to another, according to the company's risk management.⁴⁴³ Studying and disclosing company risk is important to help the company chart an appropriate course, and to psychologically prepare investor to accept risk while providing reassurance of the company's ability to cope and resolve risk related matters. This will give the company internal stability and confidence in its ability to cope with potential risks without a sudden shock such as a collapse of the company's share price in the market.⁴⁴⁴

Some studies conclude that risk disclosure weakness is one of the most prominent⁴⁴⁵ problems faced by companies today. It is a failure that can undermine overall investor confidence in the market potentially provoking a larger financial crises such as in 2008.⁴⁴⁶ The question is whether local investor, aware of the potential future risks to the company, for example events

⁴⁴¹ Annette Kleinbrod, *The Chinese Capital Market: Performance, Parameters for Further Evolution, and Implications for Development* (Springer Science & Business Media 2008).

⁴⁴² Saleem Sheikh, *A Guide to The Companies Act 2006* (Routledge 2013).

⁴⁴³ 'Managing Uncertainty, Mitigating Risk - Tackling the | Nick Firoozye | Palgrave Macmillan' (2016) <<http://www.palgrave.com/us/book/9781137334534>> accessed 4 April 2017.

⁴⁴⁴ Philip M Linsley and Philip J Shrides, 'Risk Reporting: A Study of Risk Disclosures in the Annual Reports of UK Companies' (2006) 38 *The British Accounting Review* P387.

⁴⁴⁵ Sheikh (n 438).

⁴⁴⁶ 'Corporate Governance and the Credit Crunch | ACCA Global' (2008) <<http://www.accaglobal.com/gb/en/technical-activities/technical-resources-search/2008/november/corporate-governance-and-the-credit-crunch.html>> accessed 8 April 2017.

faced by investor in the integrated telecommunications market, will nevertheless choose to invest in these companies? The answer will certainly be impacted by the behaviour of investor around the world in reaction to certain studies showing how increased levels of risk disclosure impact the decisions of institutional investor.⁴⁴⁷

In the United Kingdom, the government is offering a regulations that will oblige all listed companies to issue an Operating and Financial Review "future strategies, resources, risks and uncertainties, including policies in relation to employee and the environment".⁴⁴⁸

From the above it can conclude that the importance of disclosure of the risks. In Part IV and under Article X of the list of corporate governance paragraph 3 / b "Ensuring the implementation of control procedures appropriate for risk management by forecasting the risks that the company could encounter and disclosing them with transparency".⁴⁴⁹

It remains to say that the risk disclosure of Saudi listed firms does not create adequate information among investor who may face potential risks. The current level of disclosure does not adequately inform small investor of potential future risk, thereby limiting information regarding the desirability of available investment opportunities. Risk is a new topic on the Saudi market, therefore regulatory and educational authorities, as well as those who engage in related occupations, must give it more attention.

3.4.8 Do Existing Penalties Ensure Proper Implementation of Disclosure Rules?

If market regulators expect major market players such as investment banks, auditors, underwriters, and issuers to supply required information, a system of credible punishments must be in place to offset any perceived advantages market players may see in withholding that information.

⁴⁴⁷ Jill F Solomon and others, 'A Conceptual Framework for Corporate Risk Disclosure Emerging from the Agenda for Corporate Governance Reform' (2000) 32 The British Accounting Review P447.

⁴⁴⁸ Sheikh (n 438).

⁴⁴⁹ Corporate Governance Rules Part IV Article X.

Referring to the market's need for credible and efficient enforcement mechanisms, Alan Cameron, former Chair of the Australian Securities and Investments Commission, was quoted as saying that “we do need to understand its full ramifications, namely that the credible threat of enforcement is needed to ensure that such a system works – and that is the hard part.”⁴⁵⁰ In order for a market to achieve transparency and offer real fairness to its participants, two key elements must be present: regulations requiring issuers to disclose important information and a reliable enforcement mechanism. Information disclosure is crucial to offset existing market information asymmetry.⁴⁵¹ While disclosure rules do exist within the Saudi market facilitating a more even playing field for Saudi investor, the system is not complete.

In terms of enforcement,⁴⁵² Recital 16 of the IAS regulations provides:

“A proper and rigorous enforcement regime is key to underpinning investors' confidence in financial markets. Member States, by virtue of article 10 of the Treaty on European Union, are required to take appropriate measures to ensure compliance with international accounting standards. The Commission intends to liaise with Member States, notably through the Committee of European Securities Regulators (CESR), to develop a common approach of enforcement.”

There are sanctions for breach of Listing Rules, administrative actions are usually enforced against the listed company for breach of listed rules, including suspension, cancellation. First of all, Cancellation means de-listing a company from the stock market. Under the Saudi regulations, the Saudi Authority has the power, at any time to cancel the listing of a company as it believes appropriate, as set out in one of the overall provisions to protect investor. According to LR 5.2.1 R⁴⁵³ the FCA has a power to cancel any companies from listing. Secondly, one of the administrative sanctions is suspension which means temporarily stopping a company's shares from trading in the stock market. Saudi Listing Rules Article 35 gives the

⁴⁵⁰ Robert E Litan and others, *The Future of Domestic Capital Market in Developing Countries* (Brookings Institution Press 2003).

⁴⁵¹ Andrew Johnston, *EC Regulations of Corporate Governance* (Cambridge University Press 2009) P169.

⁴⁵² Michael HR Erkens, *Disclosure Behavior of European Firms around the Adoption of IFRS* (Springer 2016).

⁴⁵³ LR 5.2.1 : The FCA may cancel the listing of securities if it is satisfied that there are special circumstances that preclude normal regular dealings in them.

Authority the power to choose between cancellation and suspension in the same circumstances as it deems appropriate. The same thing in the UK, according to LR 5.1.1 R.⁴⁵⁴

However, Saudi regulators are empowered to issue subpoenas and inspect premises - the kind of investigative powers crucial for credible enforcement. Nevertheless, the authority is incomplete: only brokerage firms and listed companies may be inspected whereas the right to such inspection should be universal.

Reliable enforcement penalties are another key ingredient to successful enforcement. Penalties must be strong and swift enough to create a real deterrent. In the Saudi market, regulators have a range of penalties available from trivial monetary penalties and warnings to suspension. In Article 56 of the Capital Law which provides for the responsibility of continuing obligations and civil liability, but does not include a criminal penalty.⁴⁵⁵ In order to give real teeth to the country's regulatory scheme, consideration should be given to adding criminal penalties to the existing civil penalties. It could be argued that Saudi Arabia would benefit from following the example of the United Kingdom. In the UK, under FSMA 2000 s397, false disclosure is considered to be a criminal offence if it makes a false impression in the market, by for example, misleading statements. This in turn carries a punishment of up to seven years' imprisonment or an unlimited fine. A good example is the case in 2005 of *R v Bailey and Rigby* where the chief executive and the chief financial officers were convicted of misleading statements. They were sentenced to, respectively, nine months and eighteen months, in prison.⁴⁵⁶

To carry this out, penalties should target listed company directors personally, rather than being limited to the company itself. Such a position is justified in light of the fact that directors are elected by investor and given the responsibility of managing and developing the company

⁴⁵⁴ LR 5.1.1R : FCA may suspend listing

(1) The FCA may suspend, with effect from such time as it may determine, the listing of any securities if the smooth operation of the market is, or may be, temporarily jeopardised or it is necessary to protect investors. [Note: article 18(1) CARD]

(2) An issuer that has the listing of any of its securities suspended must continue to comply with all listing rules applicable to it.

(3) If the FCA suspends the listing of any securities, it may impose such conditions on the procedure for lifting the suspension as it considers appropriate.

⁴⁵⁵ Article 56 of the Capital Law.

⁴⁵⁶ *R v Bailey and Rigby* [2006] 2 Cr App R (S) 36, p. 5.

through an approach carried out within the rules of the market. Any breach of these rules is a violation of the director's fiduciary responsibilities.⁴⁵⁷

Within the current Saudi system investor are empowered to sue directors for damages if the director breaks the rules. However, this option should be extended to regulators for three important reasons. To begin with, because Saudi market investor have shown very limited activism toward enforcing director malfeasance, expanding the power to regulators could be a powerful strategy to tighten compliance. Secondly, damage created by improper director activity is not limited to investor. It additionally wreaks havoc on the market directly by undermining investor confidence. Because the threat reaches beyond the investor level, it is reasonable to allow the regulator, as representative of the market, to hold the power to sue. Finally, giving regulators the power to impose personal penalties will create a strong deterrence because directors will feel more reluctant to undertake improper actions when they could face the loss of personal assets.⁴⁵⁸

Civil liability determines the interactions between individuals or organisations. In civil liability, certain laws set out rules which must be followed – for example, who will supply the evidence. The claimant has a right to pursue a private action in the civil court against any persons who breached the disclosure rules, and also to demand compensation for any losses they have incurred. It is also possible for the authorities to act for an individual or a company to secure public enforcement. Civil sanctions involve financial penalties.⁴⁵⁹

3.5 The Stock Market Interim Reports

Saudi Arabia highlighted the importance of developing the capital market accounting information and publishing it periodically for investor, and therefore it needed investor accounting information to allow appropriate investment decisions.⁴⁶⁰ Since the annual financial reports cover a relatively long period, called the adoption of one of the ways

⁴⁵⁷Robert W McGee, *Accounting Reform in Transition and Developing Economies* (Springer 2008) P200.

⁴⁵⁸ Ibrahim A Onour, 'Testing Weak-Form Efficiency of Saudi Stock market Market' [2004].

⁴⁵⁹ 'Manuals' (2016) <<http://crsd.org.sa/En/Pages/Manuals.aspx>> accessed 14 April 2017.

⁴⁶⁰ Ku Nor Izah Ku Ismail and Roy Chandler, 'The Timeliness of Quarterly Financial Reports of Companies in Malaysia' (2004) 12 *Asian Review of Accounting* 1.

contemporary high-impact, and tangible to help investor rationalize their decisions and clarify their vision of the future. Namely, initial reports—of statements issued by companies for periods of less than a full financial year, often for a period of three months (quarterly)—address weaknesses in the annual financial reports as a source of information and reflect the historical events of the past year.⁴⁶¹

Therefore, the CMA obliges companies to publish this information and disclose it at certain times of the year—as initial quarterly financial reports—because of its impact on the market value of the shares. Based on this study that focused on the effect of knowing the announcement of quarterly earnings on stock returns in the Saudi stock market. The study used the event study method to analyse the impact of quarterly dividends on the rate of return on the stock. The market model was used to calculate the expected return and the earnings per share at equilibrium, and it compared the actual returns weekly to study the market reaction to the announcement of quarterly earnings. The results of the study indicated that the Saudi stock market was efficient overall, with strong similarities in the period between the beginning of 1989 and mid-1992. She pointed to the possible existence of factors that affected the speed-adjusted stock returns as a result of the announcement of new information, including the general economic situation and the volume of speculation in the market in that period.⁴⁶²

One of the main characteristics of the initial financial reports is that they provide useful information for allowing investor to make appropriate decisions at the appropriate time. They provide accounting information to investor at a time when they are in dire need, before they lose their ability to influence decisions.⁴⁶³

3.5.1 Importance of Interim Financial Reports

Information is considered the main pillar in the decision-making process in the field of securities investment. The investor, the issuer of the securities, and the community benefit from

⁴⁶¹ the Financial Accounting Standards (n 311).

⁴⁶² Saleh A, The Effect of the Announcement of Quarterly Earnings on the Saudi Stock Market (1996).

⁴⁶³ Robert B Dickie, 'Financial Statement Analysis and Business Valuation for the Practical Lawyer' (American Bar Association 2006) <[https://books.google.co.uk/books?hl=en&lr=&id=HrJy_8uGboMC&oi=fnd&pg=PR7&dq=Dickie,+R+\(2006\).+Financial+Statement+Analysis+and+Business+Valuation+for+the+Practical+Lawyer.+&ots=4U7zC4sL0U&sig=CMF0wn3UBovMMWNurXLGvIp_TSQ](https://books.google.co.uk/books?hl=en&lr=&id=HrJy_8uGboMC&oi=fnd&pg=PR7&dq=Dickie,+R+(2006).+Financial+Statement+Analysis+and+Business+Valuation+for+the+Practical+Lawyer.+&ots=4U7zC4sL0U&sig=CMF0wn3UBovMMWNurXLGvIp_TSQ)> accessed 4 April 2017.

the availability of accounting information, and the availability of information on the company's broadcasts reassurance to the investor, who is paid to direct investments towards optimal investments. This helps the company to collect the necessary funds, and this effectiveness leads to economic growth in the community.⁴⁶⁴

The availability of information leads, on a regular basis in the stock market and to a reasonable degree of confidence, to justice being ensured among investor. This reduces the chances of trading based on inside information, preventing investor with inside information to make profits at the expense of the rest of the investor, On the other hand, the provision of information at frequent intervals helps investor to reduce the degree of uncertainty when predicting earnings and earnings per share.⁴⁶⁵

Previously, it has been mentioned in talking about the concept of the efficient market that in the stock market, which reflects the price of all available information about the company, the initial financial reports help to achieve greater efficiency in the capital markets, since the availability of more financial reporting means that stock prices reflect the latest information on each company, which leads to more efficient pricing of securities.⁴⁶⁶

Finally, it can be say that the purpose of the initial financial reports is to improve the timeliness of information, which means the provision of information to decision makers when they need it. The failure to provide information in a timely manner led asylum investor to other sources of information that were not suitable and appropriate alternatives for making sound investment decisions.⁴⁶⁷

A study highlights the extent of the market response to earnings announcements and the initial reports of the 411 most important companies listed on the Paris Stock Exchange, over a period of three years from 1995–1997. The response was evaluated using the reactions, prices,

⁴⁶⁴ Al-Bogami (n 387).

⁴⁶⁵ 'Financial Reporting Frequency and Its Impact on the Stock Market - The Case of Switzerland by Marisa Nöldeke :: SSRN' (2005) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=997231> accessed 4 April 2017.

⁴⁶⁶ Yaw M Mensah and Robert H Werner, 'The Capital Market Implications of the Frequency of Interim Financial Reporting: An International Analysis' (2008) 31 *Review of Quantitative Finance and Accounting* P71.

⁴⁶⁷ Nor Izah Ku Ismail and Chandler (n 456).

deviations, size, and intensity of the trading, which depended on the annual accounting disclosure and semi-annual report. The study discussed the relationship between stock trading and various measures of earnings surprise and properties, during the period of the annual and semi-annual disclosure. The organisation of the market system and the disclosure of the financial situation in France were also discussed. A conclusion was reached that the governor had been arranged according to multiple criteria for projected profit, for which small deviations were found, in some cases, prior to the announcement. The study also found a strong negative deviation before the announcement of negative rates of return on the stock and identified that bad news is more disruptive than good news in the markets.⁴⁶⁸

3.5.2 The Concept of Interim Financial Reports

Due to changes and rapidly successive events experienced by companies, they were no longer satisfied by issuing annual reports, as there was increased need for information covering shorter periods than a year; hence, it was significant to derive financial reports that kept investor abreast of the results of the company's business and financial position, on an annual or semi-annual or even quarter.⁴⁶⁹ According to International Accounting Standard No. (31), preliminary financial reports must contain either a full or abbreviated set of financial statements for an initial period, and the initial period of preparation for the financial reports must be shorter than the full financial year.⁴⁷⁰

As defined by the standard, the initial financial reports issued by the Saudi Organization for Certified Public Accountants⁴⁷¹ were 'financial statements issued by the facilities for a specific period of time that (initial periods) duration of less than full financial year, usually for a period

⁴⁶⁸ Alexandros Benos and Michael Rockinger, 'Market Response to Earnings Announcements and Interim Reports: An Analysis of SBF120 Companies' [2000] *Annales d'Economie et de Statistique* P151.

⁴⁶⁹ Khaled K, 'Interim Financial Reporting, International Financial Reporting Standards within the Scientific Activities of the Securities Commission Cycle, and Financial Market in Cooperation with the Syrian Society of Chartered Accountants' (2009).

⁴⁷⁰ Saudagaran (n 327).

⁴⁷¹ *ibid.*

of three months (quarterly)’ (Saudi Commission Accountants Chartered in 1144, the Financial Accounting Standards).⁴⁷² The following can be said about the initial financial report:⁴⁷³

The period of the report should be less than one financial year and may be bi-annually, quarterly or monthly, depending on the respective state laws. Moreover, these reports are different from reports that are for a special purpose or for internal use, even if they are characterized by the patrol. Interim financial reports for both internal and external use. Furthermore, Preliminary financial reports are not a substitute for annual financial statements, but rather complement them. Also, The purpose of these reports is to provide users with information that will help them make better decisions in stock market; and these reports provide accounting data, appropriate properties, and the appropriate time to make decisions.

However, with recent technological developments in the world of business, the need for the periodic disclosure of business results and the financial condition of the facilities is necessary to provide information to users in a timely manner, and with regard to the timing of the initial reports, two questions should be asked:

1) What is the time period that must be considered for preparing the interim financial reports (semi-annual, quarterly, monthly, etc.)? 2) How long after the end of the period should ‘interim financial reports’ be published? It is common for the initial reports to prepared semi-annually or quarterly; some countries, such as the US and Canada, adopted initial reports on a quarterly basis, while other countries, such as Britain and France, adopted a semi-annual basis.⁴⁷⁴

Those that support the preparation of semi-annual reports over quarterly reports believe that the quarterly reporting is not reliable at predicting annual financial results as a result of seasonal factors. For example, a company may announce huge profits in one of the quarterly reports, while the same company will announce losses in the annual report. In addition, there are many problems with the allocation of costs in the initial reports, but these problems can be mitigated in the semi-annual reports, while being exacerbated in the quarterly reports. On the other hand,

⁴⁷² the Financial Accounting Standards (n 311).

⁴⁷³ (Abu al-Qasim) M, The Need for Interim Financial Statements as Input to Increase the Effectiveness of Accounting Information Published and Rationalize the Investment in the Stock Market Decisions (2009).

⁴⁷⁴ Al-Bogami (n 387).

favourable opinions of the quarterly reports are based on the benefits to investor, as the access to information at the appropriate time is greater than any potential problems from the quarterly reports. Furthermore, the problems with cost allocation in the initial reporting can be alleviated by setting the initial reports in accordance with the principle of complementarity.⁴⁷⁵

Researcher supports quarterly reports, as the important thing for investor is the availability of reliable and timely information for decision-making, even if it is less accurate. As a study was conducted by Ismail and Chandler, the study examined the timing of the initial financial reports issued by companies listed in the Kuala Lumpur Stock market and focused on determining the relationship between the timing and characteristics of the firm, such as size, profitability, growth, and capital structure. The study analysed 117 quarterly reports for the period ending September 31- 2001, except for one company that delayed issuing a quarterly annual report for more than two months, i.e., the maximum period. The study provided evidence for an important link between the timing of the reports and the four characteristics of the companies.⁴⁷⁶

3.6 Conclusion

This chapter has dealt with the protection of investor from the perspective of the disclosure regime under the current regulations of disclosure in Saudi Arabia. As was referred to previously, a stock market with meaningful disclosure rules and the readiness to enforce them is one of the key elements that ensures the protection of investor.

The importance of disclosure appears, for the investor and the market, to be stimulated through an interest in securities, on the basis of the information published through the financial statements and reports prepared by the company. This ensures that investor build realistic expectations for revenue that could be generated by these securities. It is these key considerations that help investor make appropriate investment decisions after developing a sound footing away from any rumors and speculation. Therefore, the disclosure provides a level of protection for investor, and, in addition, helps to improve the company's image, which eventually lead to the protection of investor.

⁴⁷⁵Mensah and Werner (n 462).

⁴⁷⁶Nor Izah Ku Ismail and Chandler (n 456).

From the results of this chapter, it can be seen that the disclosure of information about the future of the company and its activities has a role in promoting confidence in the financial reports of listed companies in the Saudi stock market which will reflect the confidence of investor. The chapter also details the importance of risk disclosure to prevent the damage of rumors as well as the importance of the disclosure of material information and remuneration of the board of directors. Rumours can be considered harmful to the integrity of any stock market, and therefore, using disclosure rules can attempt to eliminate the dissemination of rumours and false or misleading news. To enhance disclosure in the stock market is to ensure the accuracy of the information contained in financial statements, and therefore it should enforce regulations that obliges members of the board of directors to take responsibility for any errors, fraud, or manipulation. The disclosure of these elements creates a positive investment atmosphere that is free of fraud and details any conflicts of interest between managers and investor. It also prevents illegal speculation, which, in turn, helps the development of, and enhances confidence of investor in the stock market.

However, there have been criticisms as to how a potential shortcut in the regulations has led to considerable uncertainty and a lack of clarity with regard to the instruction. This includes the regulations, and how to deal with the rumours that inevitably trade in the market and articles regarding disclosure of material information. This shows the extent of the shortcut that has been taken in respect to the obligations of disclosure in the Saudi stock market regulations. It is something that needs to be reviewed, and detailed regulations developed as a consequence, in order to assist the investor.

It has been discussed that the market's need for reliable and effective enforcement mechanisms and in addition to this it can be seen that credible enforcement penalties are crucial element in effective enforcement, and therefore it should be considered whether it would be beneficial to add criminal penalties to the existing civil penalties. To be effective, it can be argued that penalties should target listed company directors directly, rather than being limited to the company itself.

As previously stated, market efficiency is linked to the availability of information. Such disclosure leads toward a reduction in asymmetric information, which is one of the main sources on which investor, within joint-stock companies, base their investment decisions. It is, therefore, important to prepare interim financial reports, to provide a source of access to

appropriate information, to enable investor to make the appropriate decisions. It is vital that these interim financial reports are then made available to investor as they will contain information that could affect stock prices.

As a result of the conclusions drawn from this chapter, the proposal is to reduce the irregular period, specified for the publication of the interim financial reports by the CMA, from fifteen days from the end of the period to ten days. It is considered that this would improve the appropriate time for publishing preliminary information, thereby reducing the potential for any leak of information before it is advertised.

The CMA identified a need for seminars and workshops to be arranged to raise awareness of the terms 'investment and financial' for investor, in order to illustrate the importance of the information published in the interim financial reports, prior to making investment decisions. There is also a need to conduct further studies on the factors that lead to variation in the market, following the announcement of the preliminary financial reports between quarters. It is also considered logical to identify the motives for investment in the Saudi stock market in order to identify the foundations upon which investor make investment decisions.

This chapter argues that investors' knowledge, and the way in which information is obtained and used, are problems in the Saudi Stock Market. It also stresses the importance of investor education and the need for stricter disciplinary actions against market manipulators who are taking advantage of small investors' lack of experience. Moreover, it proposes some reforms in the legislation, such as stricter disciplinary actions against market abuse, tighter supervision and some necessary changes to the disclosure rules.

The researcher also noted that the lack of Arabic studies, dealing with initial financial reporting in general, and the lack of studies in Saudi Arabia in particular. Many of the previous studies, all of which depended on weekly stock prices, were completed before the application of the electronic trading system in 2001. This system contributed to the development of the Saudi stock market before the collapses of the market in 2005 and 2006 and the establishment of the Saudi Stock market (Tadawul) in 2007. The importance of the current study for Saudi Arabia and the environment currently appears on the stock market. After regulatory developments in the market, recent fluctuations in stock prices prompted investor to increase interest rates in the information contained in financial reports.

Chapter 4: Insider Trading in Saudi of Stock Market-Challenges and Opportunities

4.1 Introduction

Compared to other illegal actions, insider trading remains, at least among legal academics and economists, one of the most controversial economic transactions. A number of practices have a harmful effect on investor level of confidence.⁴⁷⁷ Saudi has not been immune from insider trading, as has been indicated in chapter one in crash of the Saudi stock market section. These practices fall under the general title of market abuse, which can be divided into two main categories: insider trading and market manipulation. The main aim of this chapter is to compare the regulations of insider trading in Saudi Arabia with that in the UK. The second category, market manipulation, will be explored in the following chapter.

As indicated in the last chapter, due to the increasing importance of information in the financial market, investor should be protected by having access to information that enables them to make credible investment decisions. Selling or buying shares based on confidential information leads to personal financial gain at the expense of people who do not have access to the same information. This imbalance creates inequality and undermines investor confidence in the integrity of the market.

According to a study Bhattacharya and Daouk the 103 countries that have stock market reveals that insider trading laws exist in 87 of them, but enforcement - as evidenced by prosecutions - has taken place in only 38 of them.⁴⁷⁸ It can be seen that a very similar situation currently exists in the Saudi stock market. Saudi Arabia only introduced a framework for dealing with insider trading in 2004 and therefore regulations are still in development.

⁴⁷⁷ Emiliós E Avgouleas and others, 'The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis' [2005] OUP Catalogue.

⁴⁷⁸ Utpal Bhattacharya and Hazem Daouk, 'The World Price of Insider Trading' (2002) 57 The Journal of Finance P75.

This chapter aims to answer the question as to whether the regulations of insider trading in the Saudi stock market protects investor from insider trading. It will do this by critically reviewing the existing legal framework in order to assess the effectiveness of current Saudi laws for preventing insider trading and mitigating crime, in addition to their level of complexity. In addition, this chapter examines the socio- environments of Saudi Arabia to see whether the future regulatory efforts that CAM may undertake are likely to succeed from the perspective of investor protection.

In order to analyse insider trading regulations in Saudi Arabia three significant matters that must be addressed to deal effectively with insider trading, were identified. These are: defining the activity, sanctions, and enforcing civil or criminal liability. In order to implement effective regulations against insider trading it is essential to define it correctly. The definition of insider trading has to cover the following four areas: who is an insider; what is inside information; how is inside information transferred; and what action is banned.

4.2 Definition

The term *insider trading* has been used in different spheres and has been examined from several aspects. This section reviews the definitions of insider trading according to economic and legal concepts.

4.2.1 The Concept of Insider Trading

Insider trading can be defined as dealing in the securities of a company for the purpose of obtaining the benefits of a person possessing information that affects the prices of those securities if disclosed.⁴⁷⁹ Another researcher says that insider trading happens when an individual or entity with prior knowledge of generally unavailable information on securities tries to purchase or sell those securities; that information, if given to the public, would materially affect the prices of those securities.⁴⁸⁰

⁴⁷⁹ M Oliver and E Marshall, *Company Law* (10th edn, Stevens & Sons 1987).

⁴⁸⁰ G Morse and others, *Company Law* (12th edn, Stevens & Sons 1983).

4.2.2 The Economic Concept of Insider Trading

During the War of 1812 between the United States and Great Britain,⁴⁸¹ a seller entered into a contract to sell tobacco to a buyer at an agreed price. Prior to the completion of the transaction, the buyer was warned that the end of the war might affect the price of the tobacco and did not wish to disclose that information to the seller. A debate arose in the Supreme Court, which held that the buyer was not obliged to disclose this information to the other party.⁴⁸²

In the same context, the case of *Bell v Lever Brothers Ltd*⁴⁸³ represents an example of an imbalance in the information provided by Lord Atkin: 'A buys a roadside garage business from B, abutting on a public thoroughfare; unknown to A but known to B, it has already been decided to construct a bypass road which will divert substantially the whole of the traffic from passing A's garage. There is an enforceable contract and A is entitled to recover and retain the purchase price. The same would be true if B knew that A was unaware of the intended plan to construct a bypass road.'⁴⁸⁴

The cases described above represent the economic dimension of insider trading. They illustrate the insufficiency and imbalance of information between parties, whereby a preferred party is privy to more information than the other party and is able to earn profit or avoid loss, which is contrary to the efficient market hypothesis theory.⁴⁸⁵

4.2.3 The Legal Concept of Insider Trading

When corporate insiders directors, officers or employees know in some way that their company will be merging with another company and then trade on the Stock market on the basis of this information before it is made public, these parties might benefit from buying shares at a lower price.⁴⁸⁶

⁴⁸¹ This War was in 1812 which is a military conflict, that has been permanent for two and a half years, fought by the United States of America against the United Kingdom of Great Britain and Ireland.

⁴⁸² *Laidlaw v Organ*, 'Laidlaw v. Organ' [1815].

⁴⁸³ Compare Lord Atkin in *Bell v. Lever Brothers* [1932] A.C. 161, 224.

⁴⁸⁴ Richard Stone and James Devenney, Text, Cases and Materials on Contract Law (Routledge 2014) P425.

⁴⁸⁵ Frederic S Mishkin, The Economics of Money, Banking, and Financial Market (Pearson education 2007) P693.

⁴⁸⁶ Barry Rider and others, Market Abuse and Insider trading (Bloomsbury Publishing 2016) p424.

As in the aforementioned case of *Laidlaw v Organ*, it is legally and ethically acceptable to buy or sell shares based on information collected from the stock market and public shareholding companies.⁴⁸⁷ Trades should be based solely on this financial information. Problems arise when this information comes through confidential sources. These sources gain this information due to the virtue of their position or due to their association with others insider, and this violates the fairness of the stock market. The knowledge does not come from the individual's efforts to monitor the stock market and analyse public data but from privileged information, creating an unfair advantage.⁴⁸⁸

It does not enter into the concept of inside information with respect to findings based on economic and financial research and analysis. Mere rumours are not considered insider information, as insider information must include a specific meaning and be based on fact. Even exploitative rumours are not considered insider information, even if they later turn out to be true, as the issue of the issuance of the information rather than the time of the issuance of that information.⁴⁸⁹

In the case⁴⁹⁰ of *R v De Berenger*,⁴⁹¹ when Berenger falsely reported Napoleon's death, stockbrokers and the public were forced to buy into the government debt, through which Berenger and members of the syndicate gained their advantage.⁴⁹² Under UK legislation, insider trading can be considered on two levels—criminal conduct and civil sanction—which the Financial Services and Market Act 2000 (FSMA)⁴⁹³ defines as prohibited behavior. So The UK vision toward insider trading is comprises four prohibited forms: dealing (based on inside information), encouraging other to do so, procuring, and disclosing the inside information.⁴⁹⁴

⁴⁸⁷ Organ (n 478).

⁴⁸⁸ Dennis Campbell, *International Securities Law and Regulations* [2009]-I (Lulu com 2009) vol 1.

⁴⁸⁹ Stephen Griffin, *Company Law: Fundamental Principles* (Pearson Education 2006).

⁴⁹⁰ *R. v. de Berenger* (1814) 3 Maule & S. 67.

⁴⁹¹ Wunmi Bewaji, *Insider Trading in Developing Jurisdictions: Achieving an Effective Regulatory Regime* (Routledge 2012) PP12,13.

⁴⁹² New Zealand Governance Centre, 'Insider Trading and Market Manipulation Overview - White Collar Crime and Serious Fraud Conference' (2010).

⁴⁹³ The Financial Services and Market Act 2000 : 'is an Act to make provision about the Regulations of financial services and markets; to provide for for insurance, investment business and banking, which is made by the Parliament of the United Kingdom that fashioned the Financial Services Authority (FSA)'.

⁴⁹⁴ Following several unsuccessful governmental initiatives. In June 1980, insider trading became

Therefore, selling or buying shares based on this confidential information leads to personal financial gain at the expense of people who do not have access to the same information. This imbalance undermines confidence in the stock market, which leads to many people being reluctant to invest in stock market. As a result, the market loses value, and economic growth is obstructed. Hence, fear of unlawful interference in the stock market has a significant impact.⁴⁹⁵

Lawmakers pay attention to the stock market and protect against dangers that could affect the national economy. In Britain, the first ban on the exploitation of information occurred in the year 1696.⁴⁹⁶ From this idea, a body of parliament emerged to prosecute individuals guilty of trading scams.⁴⁹⁷ However, these measures were not sufficient, and the British Parliament adopted the Companies Act of 1980, which banned the exploitation of insider information. This was then replaced by the Company Securities “Insider trading” Act of 1985⁴⁹⁸ and then,

regulated through Part V of the Companies Act 1980. Furthermore, in 1985, the Companies Act was modified by adding insider trading to the Companies Securities (Insider trading) Act 1985. Then, in 1986, insider trading was amended by financial services. UK Government gave more authorities to enforce the insider trading provisions under the Financial Services Act 1986, sections 173-178. The provisions were cancelled under both the Company Securities (Insider trading) Act 1985 and the Financial Services Act 1986.

The self-regulatory regime at the time was also a reason for inefficiency. The powers gave to the UK Government by the FS Act 1986 that made little progress. Despite the fact that insider trading has been illegal in the UK since 1980, there were still some challenges to successful prosecution. However, the Company Securities (insider trading) Act 1985 banned insider trading, and the offence of insider trading is contained in Part V of the CJA 1993. See US Senate and others, ‘Illegal Insider Trading: How Widespread is the Problem and is There Adequate Criminal Enforcement’ [2006] Hearings Before the Comm on the Judiciary. And see Stephen Weatherill, *Cases and Materials on EU Law* (Oxford University Press, USA 2014) P73.

⁴⁹⁵ Iosco, ‘Report of the Emerging Market Committee of the International Organization of Securities Commissions. Insider Trading How Jurisdictions REGULATE IT’ [2003].

⁴⁹⁶ The Commissioners reported 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 fall into unskilful Hands. see ‘House of Commons Journal Volume 11: 25 November 1696 | British History Online’ (2015) <<http://www.british-history.ac.uk/commons-jrnl/vol11/pp593-598>> accessed 8 April 2017.

⁴⁹⁷ Before 1980, the United Kingdom had no obvious law forbids insider trading, as is illustrated in the famous case of *Percival v Wright*.

⁴⁹⁸ The rules were as follows:

finally, the Criminal Justice Act of 1993.⁴⁹⁹

The Saudi vision of insider trading violates partial transparency and disclosure of information, which creates an unfair advantage. Which Article 50 of the Saudi capital Market Law (2003) states: “Any person who obtains, through family, business, or contractual relationship, inside information (hereinafter an ‘insider’) is prohibited from directly or indirectly trading in the Security related to such information, or to disclose such information to another person with the expectation that such person will trade in such Security.”⁵⁰⁰

Accordingly, the regulatory approach in the current legal frameworks of KSA was originally adopted “parity-of-information” theory.⁵⁰¹ Accordingly, all investor are prohibited from dealing if they have obtained non-public sensitive information. The foundation of the prohibition against insider trading in this theory is based on ‘fairness’ and ‘equality of access to information’. The philosophical foundation of insider trading law in KSA and UK as has been seen is based on what has been called the "market stability theory", which aims to protect market integrity and stability. This approach is dissimilar to what can be found in other

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

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

⁴⁹⁹ Bewaji (n 219).

⁵⁰⁰ Article 50 of the Saudi capital Market Law (2003) .

⁵⁰¹ Roberta S Karmel, *The Relationship between Mandatory Disclosure and Prohibitions against Insider Trading: Why a Property Rights Theory of inside Information is Untenable* (HeinOnline 1993).

jurisdictions as that of the U. S. where insider trading is linked with fiduciary duty and which based on the misappropriation theory.⁵⁰²

4.3 Should Insider Trading Be Legal?

Current debates focus on whether insider trading should be regulated in the stock market. My view, which will be supported throughout the discussion, is that insider trading has a deleterious effect on investor level of confidence and integrity of the stock market⁵⁰³. This is apparent in the following four pillars that determine how harmful insider trading is to the stock market: fairness and the ethics of insider trading, the effect of insider trading on transparency,

⁵⁰² Marc I Steinberg, 'Insider Trading, Selective Disclosure, and Prompt Disclosure: A Comparative Analysis' (2001) 22 U Pa J Int'l Econ L P635.

⁵⁰³ Contrary to an overwhelming consensus, a considerable number of professional economists and legal theorists⁵⁰³, believe that laws making insider trading illegal should be revoked. The key point to this argument is that fraud will be discovered earlier. Moreover, one of the main benefits of insider trading being legal is that companies will either disclose all relevant information, or will themselves impose confidentiality rather than being satisfied with the idea that the rule somehow protects their secrets. Some believe that insider trading is a legal form of compensation for company employees, authorizing lower salaries to benefit stockholders. This concept is an encouraging innovation, however, some argue that promising rewards for developing a strategy or product would cause a rapid increase in the stock. See Seyhun, H (2000). *Investment Intelligence from Insider Trading*. London: MIT Press. PP28-30. Professor Kevin Depew, who writes frequently on market psychology, is of the opinion that "making insider trading legal would have no discernable impact on the markets," he says. "It's already considered an insider's game, so why would making insider trading unenforceable by legalizing it have any effect on investor psychology? Every day, there are countless trades being made using inside information as well as trades being made on the assumption that someone else has some sort of inside information. Insider trading is already, essentially, legal." See 'Should Insider Trading Be Legalized? October 19 2009 07:35 | Business News | Minyanville's Wall Street' (2009) <<http://www.minyanville.com/businessmarkets/articles/insider-trading-Rajaratnam-minyanville/10/19/2009/id/24985?page=full>> accessed 8 April 2017. Also, Doug Bandow, a senior fellow at the Cato Institute, for example, writes: "The objective of insider trading laws is counter-intuitive: prevent people from using and market from adjusting to the most accurate and timely information. The rules target "non-public" information, a legal, not economic concept. As a result, we are supposed to make today's trades based on yesterday's information. Unfortunately, keeping people ignorant is economic folly. We make more bad decisions, and market take longer to adjust" See Ralston, 'Whispers Made Me Rich' (2013). However, Until now, arguments for the revocation of insider trading laws have received little serious attention. Some critics argue that insider trading laws create only 'the illusion of fairness' and that small traders are convinced that they have a fair chance while, in fact, they are habitually overpowered by large traders. The debate outlined above elucidates that the recommendations regarding the laws of insider trading by academics and researchers differ extensively. This can be attributed to 1) differences in the standards used to assess insider trading; and 2) differences in whether the implications of the effects of insider trading on the economy are regarded as positive or negative.

in formativeness and on the efficiency of the market and the protection of investor and confidence in the market; and international regulatory standards as justification for regulations. Insider trading is considered illegal in most international and national laws so that the average investor will not capitulate to unfair advantages.⁵⁰⁴

Fairness and the ethics of insider trading: One of the most common arguments against insider trading is based on ‘fairness’ and ‘equality of access to information’. Some commentators believe that insider trading is unfair because it enables certain stock owners to benefit by obtaining pertinent information before it can reach other investor, leading to the exploitation of inside information in stock market operations.⁵⁰⁵ As Gregory and Linen argue, the greater the transparency, the more investor can enjoy a sense of equality and justice in financial markets, and the happier these investor will be to provide capital. Transparency means providing information for the future protection of investor and for increasing community awareness that the company is able to fulfil its obligations.⁵⁰⁶

The effect of insider trading on transparency, in formativeness and on the efficiency of the market: A significant perspective from which to discuss the subject of insider trading is whether it has an impact on the transparency and efficiency of the market. Economists rely on theories showing a relationship between insider trading and the transparency and efficiency of the market,⁵⁰⁷ the concept that has been embraced by economists is the relevance of stock market information. Stephens and Beck-Dudley introduced an important thesis on the relationship between insider trading and the Efficient market theory.⁵⁰⁸

With the breadth and pace of economic activity, it has become necessary to have strong financial markets. The stock market, which represents the most important area of investment and allows profiting of both large and small investor, requires the availability of a sufficient

⁵⁰⁴ Jie Hu and Thomas H Noe, ‘The Insider Trading Debate’ (1997) 82 Economic Review-Federal Reserve Bank of Atlanta P34.

⁵⁰⁵ Ian B Lee, ‘Fairness and Insider Trading’ [2002] Colum Bus L Rev 119.

⁵⁰⁶ Jonathan R Macey, Insider Trading: Economics, Politics, and Policy (American Enterprise Institute 1991) P27.

⁵⁰⁷ H Nejat Seyhun, ‘Insiders’ Profits, Costs of Trading, and Market Efficiency’ (1986) 16 Journal of Financial Economics P189.

⁵⁰⁸ CARYN L BECK-DUDLEY and Alan A Stephens, ‘The Efficient Market Theory and Insider Trading: Are We Headed in the Right Direction?’ (1989) 27 American Business Law Journal P441.

amount of information about traded financial securities in order to characterize efficient markets, especially since stock price values fluctuate from year to year and from period to period, and are often affected by data and information about the market and export company conditions, which reflect directly on the prices of traded securities.⁵⁰⁹

Regardless of its degree of influence in investment decisions, and whether information is public or private, information refers to data, news and the numbers of confirmed and unconfirmed indications that relate to a particular economic reality group. This information may relate to the state and the government in general, a commercial company or the management of public or private administrations.⁵¹⁰ General information, such as that published in newspapers and specialized websites, should be available to all; however, certain private information may be unannounced, such as that offered by advisory centres when conducting studies and economic research into various fields of investment for a particular investor to enable it to take an appropriate decision. Sometimes, confidential information prohibits the dissemination of information by third parties except in accordance with official procedures, such as those that affect a significant impact on a stock or when the system imposes the obligation to maintain price confidentiality.⁵¹¹

The importance of such information is determined by how great a benefit an interested person in possession of the information will gain from it, and the value is associated with the extent of confidentiality. The value of information decreases as the number of individuals having access to it increases. Moreover, this value is linked to how easy or difficult it is for third parties to obtain the information, in the sense that funds and effort often must be expended to acquire it. Information plays an important role in stock market transactions, whether they are for or speculative investment or not, because it provides an indication of the direction of the market and the performance of companies, allowing traders to make informed investment decisions. Information is one of the most important indicators of the practical reality of the companies listed in the stock market; it directly impacts investment decisions. However, there are several types of information, and these types are not all equal in terms of value and importance. It is

⁵⁰⁹ Asli Demirgüç-Kunt, *Financial Structure and Economic Growth: A Cross-Country Comparison of Banks, Markets, and Development* (MIT press 2004) P143.

⁵¹⁰ Awwad Saleh Awwad, 'Legal Regulations of the Saudi Stock Market: Evaluation, and Prospects for Reforms' (University of Warwick 2000).

⁵¹¹ Fernando (n 317).

crucial that the laws and regulations protect confidentiality and maintain conservation of this information by imposing penalties on those who disclose it or on those who do not reveal information that must be disclosed.⁵¹²

Therefore, the key ingredient that is lacking in low efficiency market is easy access to information about companies and their shares. If there are numerous dealers in a market, stock prices are affected and the cost of dealing in the market rises.⁵¹³ Furthermore, the movement of stock prices in the market in the form of random paths does not reflect the information on company shares. Not all dealers in a market have the same opportunities to make a profit when there is a large class of traders and market makers who have easier access to information.⁵¹⁴

Due to the increasing importance of information in the financial market, market security laws impose an obligation on issuers to immediately announce information to prevent exploitation by insiders in order to ensure equality in access to market information to protect investor. Insider information, in essence, is known only to a limited number of people who, by the nature of their work in a company have access to relevant information, which puts them in a privileged position over other dealers. Such individuals could exploit their position for profit or loss prevention, which adversely affects justice and equality in financial market transactions. As a result of such exploitation by dealers, several economic crises emerged that shook the global financial market. Saudi companies and the capital market system have been keen to impose obligations on those who possess such information not to disclose it, or use it for their own good or for the benefit of others, before it is announced to the general public, in order to achieve justice and equality of access to that information. These regulations include provisions that criminalize insider trading behaviour and deter it with sanctions in order to maintain the integrity of the market and protect investor.⁵¹⁵

Protection of investor and confidence in the market: Another rationale for regulating insider trading is that investor should be protected so that market confidence is maintained. The integrity of the market is vital to its efficiency. As previously mentioned, investor in the stock

⁵¹² Gigler and Hemmer (n 320).

⁵¹³ Michael S Rozeff and Mir A Zaman, 'Market Efficiency and Insider Trading: New Evidence' [1988] *Journal of Business* P25.

⁵¹⁴ Mensah and Werner (n 462).

⁵¹⁵ Rozeff and Zaman (n 509).

market need access to information that enables the making of sound investment decisions. The use of inside information by select investor creates inequality and undermines investor confidence in the market and its integrity; leaked internal information and exploitation are the main causes of weakness and instability in the market. Therefore, to increase investor confidence, improve market liquidity and positively affected the market as a whole, it is necessary to consolidate the principles of justice and the right of access to information among all dealers without exception.⁵¹⁶

Leaking internal information and a lack of transparency are harmful to a large number of dealers. This situation requires the creation of clear, strong standards for the maintenance of transparency and the prevention of the diversion of information so that justice among investor can be realized. Equal access to information for all investor is one of the challenges facing any securities market; the inability to protect the confidence of small investor is a fundamental reason why some refrain from investing in the stock market, thereby hampering its development.⁵¹⁷ Loss of confidence in the market has led to investors' fears of dealing with the financial market. Therefore, these negative effects should be eliminated by criminalizing the exploitation of inside information and protecting investors' confidence.⁵¹⁸

4.4 Insider Trading in the Saudi Securities Law

Three elements are necessary for insider trading to take place: 1) an insider 2) insider information and 3) a transaction based on this information. The most important elements are “insider” and “inside information” since the definition of these two terms is the central point of the problem of examining the law of insider trading.

4.4.1 Who is an Insider?

In order to offer certainty in the rules regulating insider trading, there has to be a clear definition of the elements in the action of “insider trading”. The insider must be aware that the

⁵¹⁶ Barry Alexander K Rider and others, *Guide to Financial Services Regulations* (CCH Editions 1997) P101.

⁵¹⁷ Stewart C Myers and Nicholas S Majluf, ‘Corporate Financing and Investment Decisions When Firms Have Information that Investor Do Not Have’ (1984) 13 *Journal of financial economics* 187.

⁵¹⁸ *ibid.*

information he/she obtained is inside information. Moreover, he/she must have obtained from insider issuer. The FSMA 2000 defines an insider as follows:

“An ‘insider’ is any person who has inside information: as a result of their membership of the administrative, management or supervisory body of an issuer of qualifying investments; and as a result of holding capital of an issuer of prescribed investments; , or as a result of having access to the information through their employment, profession or duties; as a result of criminal activities; or which they have obtained by other means, eg a tip-off from a friend, and which they know, or could be reasonably expected to know, is inside information.” Moreover, Article 50 of the Saudi capital Market Law (2003) defined insider: “Any person who obtains, through family...)⁵¹⁹

According to Saudi capital Market Law (2003) and CJA 1993, insiders can be divided into the following two categories: Primary Insiders, this category includes the president of the company, the debtor public officials, members of the public administration, the managing director, and members of the supervisory board, as well as the major contributors within some systems.⁵²⁰ They are supposed to flag special company information because they have decision-making authority by virtue of their position in the company.⁵²¹

Secondary Insiders, according the UK and KSA regulations secondary insiders who are those persons who have received or obtained information directly or indirectly from a person who is an insider. However, under the CJA 1993 and the ISA 2007 there is no obligation of a relationship between the tippee and the inside source. On other hand there, is a requirement of knowledge of the source of information. This requirement will limit the scope of insiders, which let to be almost impossible to prove.

This category includes all the company's employees from non-range managers, such as the secretary general manager or the secretary's chief financial officer,⁵²² and those who are not related to the functional work of the company, but the nature of their professions and their work

⁵¹⁹ Article 50 of the Saudi capital Market Law (2003) .

⁵²⁰ Market Abuse directive, article 4.

⁵²¹ Iwona Serebyńska, *Insider trading and Criminal Law: Dangerous Liaisons* (Springer Science & Business Media 2011) PP 94,95.

⁵²² *ibid.*

allows them to know this confidential information, such as the legal advisor, accountant, and financial analyst.⁵²³

As has already been noted, financial literature used to divide insiders into primary and secondary insiders. Primary insiders were, for example, members of the board of directors, managers and in-house lawyers and accountants. These individuals were in positions which made it possible for them to gain access to information, either through their management or supervisory roles. Secondary insiders received their information from primary insiders. This could come either directly or indirectly, but however the information was transmitted, secondary insiders were clearly aware of its importance. People who could fall into this category of secondary insider included anyone who worked within an organization, but for an external agency, namely external lawyers and accountants.⁵²⁴

A number of authorities argue that this is an arbitrary and irrelevant distinction. They maintain that dividing insiders into two types adds an unwelcome complication for prosecutors and regulators, who are obliged to demonstrate not merely that an individual had inside information about a specific security, but also show precisely how they came to get this information. In addition, critics believe that this categorization does not reflect the reality of insider trading; for example, it is not common for insider dealers to deal themselves. Since insider trading invariably includes both a primary insider and a secondary accomplice, or tippee, it is pointless attempting to allocate guilt and roles between these individuals. Both are involved; both are culpable. Contemporary legislation does not distinguish between primary and secondary insiders.⁵²⁵ In the UK, for example, Section 57 of the 1993 Criminal Justice Act (CJA) defines an insider as anyone who has inside information (and knows that it is inside information), gained from an inside source (and knows that it has come from an inside source).

4.4.2 Inside Information

Here, the definition of insider information is discussed, as well as the four criteria that determine whether insider information will have a significant effect on the security in respect

⁵²³ FSMA 2000 modified by the FSMA 2000 (market abuse) Regulations 2005, section 118B (e).

⁵²⁴ Thomas Lee Hazen, 'Defining Illegal Insider Trading: Lessons from the European Community Directive on Insider Trading' (1992) 55 Law and Contemporary Problems 231.

⁵²⁵ Jeffrey F Jaffe, 'Special Information and Insider Trading' (1974) 47 The Journal of Business 410.

to market price.

4.4.2.1 Definition of Insider Information

Information plays a fundamental role in stock market, highlighting the importance of delivering investor with as much significant information as possible. Because of the importance of information in the stock market, securities regulations require issuers to immediately announce “public information” to prevent exploitation (insider information) and ensure fairness in market information access, protecting both investor and the market. It is therefore necessary to classify between public information and insider information, and it is both rational and legitimate for investor to use public information.⁵²⁶

In contrast, insider information is the fundamental problem in the regulations of insider trading. Therefore, a clear definition of insider information is needed to draw the line between public and insider information.⁵²⁷ In order to clearly distinguish between public and insider information, legislators have looked abroad for determinative insider information criteria. The Kingdom of Saudi Arabia (KSA) and the United Kindom (UK) have adopted a number of criteria regarding the definition of insider information, but the four most popular will be discussed in the next section. It is worth noting that most countries follow the same standard regarding the categorisation of information. Thus, information is insider information if each of the criteria in the definition is met.

In the UK, there are two definitions of inside information under Section 56 of the CJA 1993⁵²⁸ and Section 118(C) of the FSMA 2000. Article 56 of the Criminal Justice Act 1993 states insider information “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; is specific or precise; has not been made public; and if it were made public would be likely to have a significant effect on the price of any securities.”⁵²⁸

Article 52 of the Companies Act of 1990 states: “An individual who has information as an

⁵²⁶ John Brazier, *Insider trading* (Routledge 2012).

⁵²⁷ Dennis W Carlton and Daniel R Fischel, ‘The Regulations of Insider Trading’ [1983] *Stanford Law Review* P857.

⁵²⁸ Criminal Justice Act 1993, Article 56.

insider is also guilty of insider trading if 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 he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person”.⁵²⁹

“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.”⁵³⁰ Article V of the Saudi Market Conduct regulations has banned insider trading and prohibits a person from disclosing any inside information to any other person he knows or ought to have known will possibly trade financial securities with the relevant inside information. It also requires the disclosure of any inside information obtained from a person who is known to, or ought to have been known to, be possibly trading on financial securities with relevant inside information.⁵³¹

Article IV of the Saudi Market Conduct regulations defined inside information as information specifically related to financial papers that have not been advertised to the general public, was information not available to them in any other form, and which the average person would understand that if the nature and content of that declaration were made public it would affect the price of the securities and their value.⁵³²

4.4.2.2 The Four Criteria of Insider Information

The insider information definition includes four criteria. First, the information must be non-disclosed information. Second, the information must be correct. Third, the information will affect the price. And fourth, the information is related to the issuer of those shares.⁵³³

⁵²⁹ Companies Act of 1990, Article 52.

⁵³⁰ *ibid.*

⁵³¹ Article V of the Saudi Market Conduct Regulations .

⁵³² *ibid.*

⁵³³ CJA 1993, s56; FSMA 118 (7); Rider, B. Alexander, K. Linklater, L.p46.

4.4.2.2.1 Non-Disclosed Information

Insider information must be undeclared, confidential. If the stock information is unknown to the public, and the insider or other, either by virtue of kinship or friendship, exploit this information when buying or selling shares of the company, then he will bear the responsibility,

⁵³⁴ According to Article 50 of the Saudi capital Market Law (2003) . ⁵³⁵

The Saudi Securities Law did not specify what information the public can act on via instructions, disclosures of exporting companies, accounting standards, and auditing standards. It could be say that an individual does not bear responsibility for dealing in stock market with information if:

1. Such relevant information and data was published once in the local daily newspaper at least in the Arabic language or came from a press statement published in at least one daily newspaper. 2. If the person submitted the information to the Capital Market Authority, and the information was part of the report issued by the board of directors or had been informed by the Capital Market Authority. 3. If the initial results were published within the company's business after the auditor conducted its initial review process. 4. If the information was received within the annual report, or a half or quarter report, prepared by the board of directors and provided to the Capital Market Authority.⁵³⁶

As a general rule, confidential information includes the data, documents, and information that are traded and examined on the boards of public shareholding companies and in the documents of auditors and inspectors.

In the UK there are two definitions of insider information. The Criminal Justice Act (CJA) 1993 uses the term “has not been made public,” while the Financial Services and Market Act (FMSA) 2000 uses the term “not generally available.” However, both definitions appear to imply the same meaning, that is as long as information is published according to stock market regulations, it is regarded as “made public” or “generally available.” Because the market needs time to absorb information, there may be a period during which insiders can take advantage before information is officially public. Once disclosure take place, they are then free to openly

⁵³⁴ Michael O’Kane, Saudi Securities Law (Michael OKane 2011).

⁵³⁵ Article 50 of the Saudi capital Market Law (2003) .

⁵³⁶ *ibid.*

use the information. Thus it is important to define precisely when information has been made public.⁵³⁷ According to the wording of the CJA 1993 and FSMA 2000, information is considered public at the time of disclosure. There is no provision for time needed by investor to absorb the information, or that the information must be reflected in the market price of securities. This gap creates a loophole that unfairly allows insiders to take advantage and escape liability. Although admittedly, it would be difficult to pinpoint when the market has absorbed the information rendering it public.

British legislators singled out a provision on the condition of public information in Article 58 of the Criminal Justice Act of 1993. Information is declared public in the following circumstances:⁵³⁸ 1) It is published in accordance with the rules of a regulated market for the purpose of informing investor and their professional advisers. 2) It is contained in records that by virtue of any enactment are open to public inspection. 3) It can be readily acquired by those likely to deal in any securities to which the information relates, or of an issuer to which the information relates, or it is derived from information which has been made public.

Article 58 of the British Criminal Justice Act of 1993 explicitly states that these cases were not limited to these examples and stipulates that information is publicly declared even if:⁵³⁹ 1. It can be acquired only by persons exercising diligence or expertise. 2. It is communicated to a section of the public and not to the public at large. 3. It can be acquired only by observation. 4. It is communicated only on payment of a fee. 5. It is published only outside the United Kingdom.

The first provision demonstrates that public information does not mean that it is already known to everyone, but it can only apply to persons who are expected to trade stocks that are affected by that information. The second provision demonstrates that information is not kept secret even when it is only published to a limited number of people compared with all the traders in the market. The information remains within the framework of confidentiality if the company has consulted a number of people, both within the company or outside, to determine the purpose of this piece of information, where the information has not been released to the general public.

⁵³⁷ Steven Huddart and others, 'Public Disclosure and Dissimulation of Insider Trades' (2001) 69 *Econometrica* P665.

⁵³⁸ Criminal Justice Act of 1993, Article 58.

⁵³⁹ *ibid.*

The third provision demonstrates that after advertising and publicity, the information is no longer confidential. The fourth provision demonstrates that statistics or data derived from the stated information by the financial analysts or economists, although it is undeclared or known to a limited number of people, are not considered confidential.⁵⁴⁰

This raises the question that if the company of the confidential information discloses it to the other contracting party, would that make the information declared and, thus, the deal legal? it has been believed that the answer to this question lies in the goal envisaged by the lawmakers: Saudi and British laws banned the exploitation of information in dealing equity, and the laws are aimed at establishing the principle of equality to protect investor⁵⁴¹ in the publication of that information and to achieve justice in transactions as the House Committee on Energy and Commerce wrote "The abuse of informational advantages, which other investor cannot hope to overcome through their own efforts, is unfair and inconsistent with the public's legitimate expectation of an honest and fair securities market where all participants play by the same rules"⁵⁴². As it can be argued that the concept of enhancing market efficiency is not the only approach for insider trading, there are another approach, which is the 'fairness perspective'.⁵⁴³

However, according to British law, the information is no longer confidential if disclosed to the other contracting party, while Saudi law may not count it as public disclosure. Publishing must be determined in accordance with the law, not the individual publishing the information.

It is possible that the information remains undisclosed, although published, as long as it did not do enough for the investor.⁵⁴⁴ It is difficult to determine the time between the dissemination of

⁵⁴⁰ *ibid.*

⁵⁴¹ *ibid.*

⁵⁴² Louis Loss and Joel Seligman, *Fundamentals of Securities Regulations* (Aspen Publishers Online 2004) PP760,761.

⁵⁴³ Lee (n 501).

⁵⁴⁴ According to the French professor, the EMH applies where there is no interval between the analysis of new information received by the market and access being granted to the specific results of the share price. This ensures immediate changes in price to reflect what was done to that information. There is, of course, no interval between the investor and others obtaining such information, and then will not have any chance of them that not available to others. This concept of the EMH is referred to as being a perfectly efficient market. The conditions that require the availability of the perfect market are as follows: All information is available to everyone at the same time and at no cost to dealers. There are no restrictions on the transaction in terms of cost or taxes. In addition to the possibility of buying or selling any amount of stock, whatever the quantity, there are no restrictions on the entry or exit of

information and the presumption of knowledge of the investor because the situation varies depending on the information, markets, times, means of publication, and the extent of the company's penetration in the market. For example, a public shareholding company that has a large market share and many investor may benefit within a few hours after information becomes public, but the duration will be much longer for those who need the information to come from an economic or financial analysis after publication.⁵⁴⁵

4.4.2.2.2 Precise Information

It is not enough for information to be undeclared; it must also be correct. Rumours are not considered insider information because the information must be precise and correct. Article 56 of the British Criminal Justice Act of 1993 states the internal information must be accurate or specific.⁵⁴⁶

The CJA 1993 uses the two terms "specific" and "precise," while section 118C (5) of the FSMA 2000 exchanges the terms "specific or precise," used in the CJA 1993, with the single term "precise." The government minister explained the difference to the House of Commons standing committee and why the term "precise" alone would be interpreted as only "narrow, exact and definitive".⁵⁴⁷ The Financial Services Authority (FSA) also offered a description of the meaning of "precise information." In the case *Arif Mohammed v. FSA*, the Financial Services and Market Tribunal held that a piece of information is "precise" even in the absence of certainty if there is still "relevant." Therefore there is a clear distinction between mere "rumours" and actual "information."⁵⁴⁸

investors. All investors seek to maximize their benefit by trading in, buying, and selling. The magnitude of investors in the market and the lack of any association between them does not affect someone that has a significant influence on the market. see Fama, E. and French, K. (1988). Permanent and temporary components of stock prices. *Journal of Political Economy*, 96(2), 246–273. Also, see Fama, E. (1970). Efficient capital markets: a review of theory and empirical work. *Journal of Finance*, 25(2), 383–417.

⁵⁴⁵ In American case *SEC v. Texas Gulf Sulphur Company*: "Plaintiff, the Securities and Exchange Commission, brought this suit against Defendants, Texas Gulf Sulphur Co., et al., after Defendants bought shares of Texas Gulf while they secretly had positive information regarding mining activities carried out by the company."

⁵⁴⁶ Criminal Justice Act of 1993, Article 56.

⁵⁴⁷ L Yves Fortier, 'New Trends in Governing Law: The New, New Lex Mercatoria, Or, Back to the Future' (2001) 16 *ICSID Review* 10.

⁵⁴⁸ *Arif Mohammed v. FSA*, 2005, Decision 012.

British courts have considered that rumours relating to a specific company may affect stock prices the same way as insider information. For example, “Elaine,” an employee at the Antrkintntal Bank, hears a rumour through her work that the company Panacea is about to announce excellent test results for the medical product Wonder Drug. Elaine then purchases 1,000 shares of the company. As the rumour concerns a specific company and affects the price of its shares, a British court has heard the case against Elaine, who has been accused of insider trading. However, Elaine was able to prove that the information (the rumour) was scattered widely.⁵⁴⁹

Accordingly, press expectations for higher stock prices are not confidential information that can be exploited. Such expectations are personal views based on assumptions, figures on the British balance of trade, or industrial output and are not specific information. The reason for the required correctness of the information lies in the lack of responsibility of the person when dealing in the shares as a result of a rumour spread that influenced the price. Furthermore, lasting price changes result from published, verified information, while rumours soon proven false result in only temporary price fluctuations. Market will always be susceptible to rumours that temporarily affect prices.⁵⁵⁰

4.4.2.2.3 Information that Affects the Stock Prices

The information prohibited in the selling of shares must be relevant to the shares of a public shareholding company, and it must also have an impact on the prices of these shares in the event of publication. Article 50 (A) of the Saudi Capital Market Authority states: “Insider information means information obtained by the insider and which is not available to the general public, has not been disclosed, and such information is of the type that a normal person would realize that in view of the nature and content of this information, its release and availability would have a material effect on the price or value of a Security related to such information, and the insider knows that such information is not generally available and that, if it were available, it would have a material effect on the price or value of such Security.”⁵⁵¹

The British Act of 1985 prohibits information “which if it were made public (information)

⁵⁴⁹ Mark Stamp and Carson Welsh, *International Insider trading* (FT Law & Tax 1996) P113.

⁵⁵⁰ *ibid.*

⁵⁵¹ Article 50 of the Saudi Capital Market.

would be likely to have a significant effect on the price of the transferable security”.⁵⁵² British law has also confirmed this approach in the law of 1993, in which Article 56 explains the information is likely to have a significant impact on stock prices. Furthermore, according to British law, if the information’s effect on stock prices is not significant or material, the criminal charges may be dropped.⁵⁵³

The question arises about the criterion on which the British law stands, on whether it is likely to materially affect the dissemination of information on stock prices. The Supreme Court of the United States of America in the lawsuit “Basic Inc. v. Levinson” laid out one method for answering this question. The court ruled: The effect is essential when there is a strong possibility of the average investor that the undisclosed information would change the decision taken, both in the sale or purchase.⁵⁵⁴ From this perspective, it can be said the information is likely to have material impact on stock prices, while British law contends the person must know the information will affect prices. The first approach seems to depend upon the average investor's decision, while the second depends on each investor’s personal knowledge of the nature of the undisclosed information.

There are many types of information that may substantially affect a company’s stock price. For example, information regarding the company's annual profits would influence the company’s stock prices, as would information that the company will change its investment policy. Other pivotal information would include the conclusion of an important contract, hiring new management, or a merger with another company to achieve significant profits. In determining the extent of the impact of information on stock prices, the standard used is the level of impact at the time of the issuance of the purchase order or sales to the broker, not at the time of its implementation, determining the impact on the stock price ratio, or the so-called “significance,” is difficult and best left to the discretion of the court authority.⁵⁵⁵

⁵⁵² Karen Harrison and Nicholas Ryder, *The Law Relating to Financial Crime in the United Kingdom* (Routledge 2016) P92.

⁵⁵³ Criminal Justice Act of 1993, Article 56.

⁵⁵⁴ Lewis F Powell Jr, ‘Basic, Inc. v. Levinson’ [1987].

⁵⁵⁵ *ibid.*

4.4.2.2.4 Information Related to Shares or the Issuer of those Shares (Companies)

It is not enough for information to be undeclared, to be correct, and to have a substantial impact on prices after the announcement, but insider information must also be related to shares or the issuer of such equity shares (the company). This information may be either external or internal.⁵⁵⁶ An example of external information would be one company submitting an offer to manage or merge with the company issuing the stock. An example of internal information would be the announcement of greater profits. Since such information relates to public companies, and not a particular company or certain companies, trading shares upon that information is not a violation of law. However, that applies only to shares that are traded on a regulated market (stock exchanges).⁵⁵⁷

It is important to note that the person who is an insider by virtue of his position or his job in the company with inside information related to shares of the company, and he is trading the shares of the company based on private information, he will be conducting prohibited trading according to Article 50 of the Saudi capital Market Law (2003).⁵⁵⁸

According to the definition of insider trading mentioned earlier, an important question arises with respect to the scope of insider information. That is whether it is considered insider information if it relates to a "single issuer" or a "group of issuers." For instance, in the UK, information is considered "insider" when it relates to "particular securities or to particular issuers of securities and not to securities generally or to issuers generally".⁵⁵⁹ However in Saudi Arabia, insider information is more narrow, relating only to traded securities. Saudi law therefore does not clearly state whether information related to issuers or securities in general is considered to be insider.

Also, an important question arises with respect to the scope of insider information. The question is whether information can be considered insider information if it relates only to stock market listed companies or if it includes companies that have not yet gone public. The KSA

⁵⁵⁶ Barry Alexander K Rider and Michael Ashe, *Insider Crime: The New Law* (Jordans 1993).

⁵⁵⁷ iosco (n 491).

⁵⁵⁸ Article 50 of the Saudi capital Market Law (2003).

⁵⁵⁹ Rider and Ashe (n 552).

limits insider information to those securities listed in the stock market. However, the prohibition against insider information is general to all companies, according to Saudi market law. Nevertheless, the scope within Saudi market law is limited.

It can be seen from this section that there is confusion over what constitutes an insider and what is an inside source and the scope of the inside source is limited to four types in Saudi law. Therefore, this confusion would be avoided if Saudi law separated the definitions of ‘insider’ and ‘inside source’ and had not limited the scope of the inside source.

For example, in the UK the Criminal Justice Act 1993 section 57 part (2) provides: (2) For the purpose... a person has information from an inside source if and only if, (a) he has it through- (i) being a director, employee or shareholder of an issuer of securities; or (ii) having access to the information by virtue of his employment, office or profession; or (b) the direct or indirect source of his information is a person within paragraph (a).⁵⁶⁰

4.4.3 Transactions

Three transaction features should be considered relative to inside information: The first feature ‘in relation to an investment, means acquiring or disposing of the investment whether as principal or agent or directly or indirectly⁵⁶¹, and includes agreeing to acquire or dispose of the investment, and entering into and bringing to an end a contract creating it’. Otherwise, ‘a person deals in securities if he procures, directly or indirectly, an acquisition or disposal of the securities by any other person’.⁵⁶²

Second, the crucial time for the commission of an insider trading offence is at the time of the selling and buying of the security according to inside information. An insider does not commit an offence if he obtains the inside information after the transaction is completed, as it is obvious he has not infringed on the provision.⁵⁶³

⁵⁶⁰ Criminal Justice Act 1993 section 57.

⁵⁶¹ Article VI of the Saudi Market Conduct Regulations banned the person who is insider with insider trading as well as the person who is not insider, meaning ignorance of the law is no excuse for committing the crime.

⁵⁶² CJA 1993 s52 (3) & s 55(1) (b); FSAM, 130A (3).

⁵⁶³ Rider and others, Market abuse and insider dealing (n 482). p48 .

The third feature is what the Criminal Justice Act (CJA) 1993 defines as ‘securities’: shares, depositary receipts, warrants, gilts, local authority stocks, and contracts for differences and debentures in companies. Also included in this list are derivatives and contractual rights of differences.⁵⁶⁴

Finally: The UK Criminal Justice Act 1993 (CJA) section 57(1) defines an insider, section 57(2) defines an inside source, section 56 defines inside information and section 52 defines prohibited activities. It should be noticed that Saudi regulations not define insider trading in this way.

4.5 Theoretical Framework for Insider Trading Sanctions

Academics and regulators have advanced a number of theories to justify and present a theoretical basis for the imposition of sanctions against insider trading. The following sections examine these theories and apply them to Saudi stock market.

4.5.1 Fiduciary Duty

The theory of fiduciary duty is considering one of the oldest theories presented as a foundation for the prohibition of insider trading.⁵⁶⁵ Moreover, in the insider trading framework, there are three categories of 'fiduciary' positions: directors, professional advisers and officers. According to the general responsibility of fidelity duty, “which the employees owe could be satisfactorily broad to create liability for insider trading”.⁵⁶⁶

Fiduciary Duty theory assumes the existence of a relationship between two parties, with one party committed to a special duty towards the other. Parties owing this duty are called fiduciaries. The individuals to whom they owe a duty are called principals. They also have a duty to avoid any conflicts of interest between themselves and their principals or between their

⁵⁶⁴ CJA 1993 s 52 (1) "An individual who has information as an insider is guilty of insider trading if, in the circumstances mentioned in subsection (3), he deals in securities that are price-affected securities in relation to the information."

⁵⁶⁵ Henry G Manne, *Insider Trading and the Stock Market* (Free Press 1966). *Faccenda Chicken L v Fowler* [1986] 1 All ER 617; *Wessex Dairies Ltd v Smith* [1935] 2 KB 80. Lord Herschell in AC44.

⁵⁶⁶ Brenda Hannigan, *Company Law* (Oxford University Press, USA 2015) P133.

principals and the fiduciaries' other client.⁵⁶⁷ The focus of commitment in this theory is to the honesty of the conditions of the contract and the circumstances surrounding it, and the preservation of the other party's interests, including non-disclosure of information and not exploiting the principal's funds for private benefit. In case of a breach of this duty, the party should return the interest that he earned to the principals who committed the duty of the fiduciary.⁵⁶⁸

4.5.2 Misrepresentation

Individuals who hold classified business data are to never pass it on, or to misappropriate it, to a third party for special profit or leverage. Such data refers to all business information and ranges from company self-generated information to every part within the company. The action in committing such an offence is termed the misappropriation theory. It is built upon two key premises.⁵⁶⁹

Firstly, the guilty party who has a fiduciary duty towards the company has to protect the classified information. This statutory charge exists because it prevents the negative situation from occurring as it means that they are bound by law not to be a detriment to the business whom they care for, and would be held legally accountable for breach of their duty. The other premise is that companies "own proprietary rights to information" and if this is violated and the perpetrator steals classified information i.e. uses it without permission, this is once more against the law. The theory also dictates that all third parties cannot use their connection to the company as any kind of transaction without the company's consent. There is no significance on the existence of any relationship between the dealer and the corporation.⁵⁷⁰

This theory rules that the company is the injured party because of impairments such as financial instability in the market and the integrity of its management when classified information seeps out, as well as the business' credibility taking a hit. The insider are the ones usually blamed

⁵⁶⁷ Loss and Seligman (n 538). P750.

⁵⁶⁸ Howard Kaplan and others, *The Law of Insider Trading* (2012).

⁵⁶⁹ Harry S Gerla, 'Confidentiality Agreements and the Misappropriation Theory of Insider Trading: Avoiding the Fiduciary Duty Fetish' (2013) 39 U Dayton L Rev P331.

⁵⁷⁰ *ibid*

too, causing them lack of credence. This explains that according to the misappropriation theory the company deserves recompense in damages or repayment of profit loss from this chain of events.

The preceding theory's necessity for the presence of fiduciary or confidence relationship is used in places such as the United States's jurisdictions.⁵⁷¹ Nevertheless, there is a further application put into action by numerous other jurisdictions, including the UK where those guilty of trading classified information "by those who have unequal access to the material nonpublic information." include "tippees" – those who secondarily trade from the wrongdoers holding the information-. This is stated in the "access" doctrine.⁵⁷²

This idea of misrepresentation holds true for the Saudi Arabian ordinance held by sharia and Islamic law theory. This is because the penumbra regulations which is situated within the "shadow" of the conventional contract regulations includes the Islamic Law of contracts and it forbids fraud (tadlees) as well as deceit (taghreer). These regulations disallow ambiguity (gharar) or deliberate attempts at falsification (ghabn or ghubn). For example, Saudi Arabian law rules that absence of disclosure can be viewed as taghreer and in such an event, the solution is to provide the aggrieved victim with the choice to annul their contract.⁵⁷³

4.6 Available Remedies

There are number of remedies are available to combat insider trading, which will be examined from a comparative perspective. The two most common sanctions are criminal and civil remedies. Moreover, this section will also cover to the concept of civil law and common law jurisdictions since the basics of such sanctions vary in both legal systems, for example, directors' duties and unjust-enrichment remedies. Criminal sanctions can be located in KSA

⁵⁷¹ Hui Huang, International Securities Markets: Insider Trading Law in China (Kluwer Law International 2006) vol 3 PP44,45.

⁵⁷² 'Misrepresentation.pdf - English Law of Contract: Misrepresentation Emily M.' (2012) <<https://www.coursehero.com/file/13920513/Misrepresentationpdf/>> accessed 8 April 2017.

⁵⁷³ 'Islamic Law of Contracts: Fraud & Deceit | Mace Abdullah - Academia.edu' (2013) <http://www.academia.edu/3639684/Islamic_Law_of_Contracts_Fraud_and_Deceit> accessed 4 April 2017.

and UK jurisdictions of insider trading regulations, which include fines and potential imprisonment if parties are found guilty of insider trading.

4.6.1 Criminal Sanctions

The regulatory regimes in the KSA and the UK are similar and a comparison between their approaches discloses the practicality of combining more than one kind of sanction. The classification of an insider trading offence relies on its characteristics, the standard of proof, the type and purpose of the sanctions and the prosecution procedures. However, there has been considerable disagreement about the regulations of insider trading in the UK, since it was regulated by the CJA 1993 (Sections 52-54).⁵⁷⁴ In addition, based in changes to the extent of liability of trading on inside information, the CJA no longer considered the concept of the theory of fiduciary duties⁵⁷⁵ to provide the necessary conditions of a link between the issuer of inside information and the individual.⁵⁷⁶ It is only a criminal offence, which results in unsuccessful prosecution in most cases. Thus, the enforcement records show that the conviction rate since 1985 has only been around 50 percent.⁵⁷⁷

It has been argued that this situation is still problematic. First, because of the term ‘standard of proof’ the suspected dealing must be proved ‘beyond a reasonable doubt’, which leads to low rate of successful prosecution. Second, insider trading is considered a criminal sanction, which is inappropriate because there are only slight differences between the legal and illegal insider trading processes. Therefore, regulators are unable to establish legislation to create a definition for an offence ‘beyond a reasonable doubt’. Furthermore, civil sanctions apply to either individuals or markets, whereas, criminal sanctions apply to individuals only.⁵⁷⁸

Moreover, it has been proposed the adoption of the US approach, which makes it a combination of criminal and civil offences, because the burden of proof in a purely circumstantial case is

⁵⁷⁴ Kern Alexander and others, *Insider trading and Market Abuse: The Financial Services and Market Act 2000* (ESRC Centre for Business Research, University of Cambridge 2001) P195.

⁵⁷⁵ Goulding, S (1996). *Principles of Company Law*. : Cavendish..

⁵⁷⁶ Alexander states that UK regulators (the Financial Services Authority) used the power of the Financial Services Act 1986, which resulted in little progress.

⁵⁷⁷ Henry Laurence, *Money Rules: The New Politics of Finance in Britain and Japan* (Cornell University Press 2001) P98.

⁵⁷⁸ JM Naylor, ‘The Use of Criminal Sanctions by UK and US Authorities for Insider Trading: How Can the Two Systems Learn from Each Other (Part Ii)’ (1990) 5 *Company Lawyer* P83.

less onerous in the civil context⁵⁷⁹. Furthermore, civil sanctions apply to either individuals or markets, whereas, criminal sanctions apply to individuals only. The reason behind unsuccessful prosecution in most cases of insider trading is that prosecution relies on the characteristics of the offence, which requires a standard of proof.⁵⁸⁰

The standard of proof—beyond the shadow of a doubt—has been the main factor in insider trading regulations. However, because of the classification of the offences and their penalties, some interesting questions have arisen. First, which standard of proof should be applied? Second, it is argued whether insider trading should require higher or lighter proof. A lighter measure of proof may be incompatible with the European Court of Human Rights (ECHR); however, a heavier measure would limit prosecution for insider trading. Insider trading regulations must consider this matter.

In *Lord Advocate v Mackie*⁵⁸¹ (unreported), Mackie who was hired by a company as an analyst was charged for encouraging others to deal based on inside information that Mackie had accessed during a briefing conference with the company chairman. However, the conviction was withdrawn on appeal because the evidence presented was not beyond a reasonable doubt. There was conflicting evidence about what was said at the meeting. The chairman reported that he had told Mackie about the company's profits, but this was not corroborated and was not sufficient to prove the case against Mackie. Information on takeover offers are required to be announced to the public. 'However, persuading a jury that they can be satisfied to the criminal standard that they are clear beyond a reasonable doubt of such guilty knowledge, even on the strongest circumstances evidence, is likely to be extremely difficult'⁵⁸².

In the UK, the legal community has called for reform to the legislation for insider trading offences. Accordingly, in May 1997, Gordon Brown, the then Chancellor of the Exchequer, announced the reform of the financial services regulations. To provide new authority to eliminate insider trading, the FSAM was given the power to address the loopholes that were left by criminal law, including the unlimited imposition of civil penalties and the terms of a

⁵⁷⁹ *ibid.* P54.

⁵⁸⁰ *ibid.*

⁵⁸¹ *Lord Advocate v Mackie* (1993).

⁵⁸² Barry Rider and others, *Commercial Law in a Global Context: Some Perspectives in Anglo-Japanese Law* (Kluwer law international 1998) P208.

lighter burden of proof. However, the debate continued as to whether insider trading under FSAM was a civil or criminal offence.⁵⁸³

Since it is usually argued that prevention is better than cure, forbidding insider trading is not sufficient in terms of limiting offences thereof. Several approaches, including enhanced corporate governance, directors' duties, and disclosure obligations, can be taken to reduce the risk of insider trading, to protect the confidentiality of inside information and improve market integrity.

Criminal sanctions can be located in KSA and UK jurisdictions of insider trading regulations, which include fines and potential imprisonment if parties are found guilty of insider trading. For instance, in KSA anyone who violates any of the provisions of the legislation and associated regulations is subject to a fine of 100,000 SR in addition to a fine of not less than twice, but not more than five times the profit achieved, or weakness or loss avoided. In the UK, the equivalent fine is no more than 5,000 pounds, and/or imprisonment for a period not exceeding six months if the case has been considered before the Magistrates Court. If the case is considered by the Crown Court, there is no limit to the amount of the fine and/or imprisonment for a period not exceeding seven years.⁵⁸⁴ The same can be said for the KSA and UK laws, as both consider insider trading to be a criminal offense.

In 1986, Lord Justice Roskill's Fraud Trial Committee reported that "... the British public had no confidence whatsoever in the ability of the criminal justice system to bring the perpetrators of serious fraud effectively and expeditiously to book. " "Lord Justice Roskill and his committee added that they considered that, on the basis of the evidence that they had received, the public was justified in this view". "The system just did not work".⁵⁸⁵

⁵⁸³ Richard Roberts, *The City: A Guide to London's Global Financial Centre* (John Wiley & Sons 2008) vol 11 P245.

⁵⁸⁴ Slaughter and May, 'Criminal Justice Act 1993 Insider trading Provisions' (2011). Available: https://www.slaughterandmay.com/media/39254/criminal_justice_act_1993_-_insider_dealing_provisions.pdf. Last accessed 10th Jan 2016.

⁵⁸⁵ Barry AK Rider, 'The Control of Insider trading—Smoke and Mirrors!' (2000) 7 *Journal of Financial Crime* 227 P9.

4.6.2 Civil and Common-Law Sanctions and Remedies

In this section, the common law and civil law view of insider trading by representative the common law approach; exposing several civil law aspects of insider trading and the possible remedies.

Civil remedies are becoming more popular with regard to insider trading. Academics and regulators believe that such measures provide the most successful tools for preventing offenders.⁵⁸⁶ civil sanctions have two main sources: the first arises from the general principles of common and civil law, whereas the second involves the use of special legislation. The Saudi legislature suggests civil and criminal liabilities for ‘manipulation’, whereas insider trading is subject only to criminal sanctions even while both manipulation and insider trading are kind of market abuse.

Saudi and UK lawmakers have not regulated for civil remedies arising from dealing in prohibited shares of public joint-stock companies. The rules underlying breach of fiduciary duty can be applied to the relationship between a company and a member of its board of directors. Saudi legislation also chooses not to regulate for a specific civil remedies arising from insider trading. It is, therefore, essential to refer to the general rules of civil remedies, which may be used to handle insider trading.

There are many theories that can be invoked with regard to civil remedies arising from trade in outlawed shares of public joint-stock companies. Banned equity deals involve breach of legal statutory duty, misrepresentation, breach of fiduciary duty and breach of confidence and/or trade secrets. This section will show how these theories relate to different demands. Then it will look at, each theory separately to determine its suitability with regard to civil remedies arising from prohibited trading.

The first main cause of action is breach of fiduciary duty: In Britain, the president or the members of the board of directors of Fiduciary Duty are committed to the company, but they are not committed by this duty towards the investor of the company they represent, nor are they committed to other companies that trade the company’s shares based on undisclosed

⁵⁸⁶ Michael P Dooley, ‘Enforcement of Insider Trading Restrictions’ [1980] Virginia Law Review 1.

information. Therefore, they are not committed to declare undisclosed information to the other party.⁵⁸⁷ As Swinfen-Eady J. held in the case of the *Percival v Wright* about the directors' duties regarding the stockholders "The directors of a company are not trustees for individual investor and may purchase their shares without disclosing pending negotiations for the sale of the company's undertaking".⁵⁸⁸

However, this distinction does not apply in Saudi law because the president and members of the board of directors of a joint-stock company have responsibility towards the company and investor for each violation committed. According to Articles 72, 73, 74, 75, 76, and 77 of the Saudi Companies Act, any breach of Fiduciary Duty constitutes a breach of the laws and regulations .⁵⁸⁹

In Saudi Arabia, the chairman and members of a company's board of directors must adhere to Fiduciary Duty based on the following: First, the text of the Article 69 of the Saudi Companies Act, which prohibits behaviours that would create a conflict of interest. Second, the text of the Article 74 of the Saudi Companies Act, members of the board of directors are not allowed to declare any information that discussed in the general assembly meetings, and it is not permitted to take advantage of what they know and use it for their own interest. Third, the board of directors is like the agent of the company and must represent and defend its interests, and then the members are committed (Fiduciary Duty) to do so in a personal capacity.⁵⁹⁰

Fiduciary Duty theory demonstrates a limited scope, as this duty, particularly in British law, does not apply towards investor of the company nor to investor in other companies trading in the first company's stock.⁵⁹¹ Fiduciary Duty also does not apply in the relationship between the company and the secondary trader, who does not have a relationship with the company, and it also does not apply in the relationship between the primary trader and a secondary party to the contract that has been buying stock from him or has sold those shares to him. Although a member of the board of directors may breach Fiduciary Duty towards the company, the

⁵⁸⁷ *ibid.*

⁵⁸⁸ *Percival v Wright* (1902). 2 ch 421.

⁵⁸⁹ 'The Ministry of Commerce and Industry & the Capital Market Authority Clarify the Mechanism of Applying the New Corporate Law' (2016) <<http://mci.gov.sa/en/MediaCenter/News/Pages/17-04-16-02.aspx>> accessed 4 April 2017.

⁵⁹⁰ *ibid.*

⁵⁹¹ Michael Ashe and Lynne Counsell, *Insider Trading: The Tangled Web* (Fourmat 1990) P117.

company can get compensation if it proves a financial loss due to this breach.⁵⁹²

The second main cause of action is breach of confidence. The aims of this theory are to avoid the disclosure of confidential information or the erroneous exploitation of it without the consent of the claimant. In this case, the insider will be guilty of violation of the claimant, according to the theory's full conditions. However, this theory is more extent than the theory of fiduciary duty. The theory of breach of confidence requires the application of three conditions: 1) the insider information must be confidential; 2) there should be a contracted obligation to maintain information confidentiality; and 3) unfair advantage has been used.⁵⁹³

When the obligation of confidentiality emerges, a party is prohibited from using or disclosing confidential information to obtain benefit for himself or for another party, or to cause harm through possession of that information. This indicates that the terms of realization of the theory of disclosure of confidential information or the disclosure of trade secrets are similar in Saudi and British laws in which there are information confidentiality requirements. Moreover, the laws of both countries state that the disclosure of sensitive information could harm the interests of the claimant or a particular party.⁵⁹⁴ According to Section 63(2) of the CJA 1993 "... makes it impossible for a contract tainted by insider trading to be declared void or unenforceable by the common law doctrine of illegality."⁵⁹⁵

From the above, it could be argued that this theory does not include a secondary trader who obtained the information but does not have a relationship with company; if a derived company relationship exists, there is an obligation to keep the information confidential. However, according to the requirements of UK and Saudi laws, this theory applies to both primary and secondary insider. The action of breach of confidence considers only the relationship between the trader and the company related to the undisclosed information, which means that this theory does not apply to other relationships between the contractor and other traders. Consequently,

⁵⁹² Chadbourne & Parke. (1). Potential Liabilities of Directors & Officers Under English Law. Available: <http://www.chadbourne.com/files/upload/DandOLiability.pdf>. Last accessed 30th JULY 2015.

⁵⁹³ Bewaji (n 219).

⁵⁹⁴ *ibid.*

⁵⁹⁵ CJA 1993 63(2).

those already affected by the exploitation of the inside information have no right to claim.⁵⁹⁶

The third main cause of action is breach of statutory duty. There is a civil right of action for breaching statutory duty. This duty of statutory assumes the existence of a legal provision that prohibits the exploitation of inside information to achieve the interests of the client, or for the benefit of others. This prohibition is stated under Article 50 of the Saudi capital Market Law (2003)⁵⁹⁷ and several provisions in the Market Conduct regulations. Article 52 and Article 53 of the British Criminal Justice Act of 1993⁵⁹⁸ banned the following activities: 1. The purchase or selling of securities based on inside information, as principal or agent. 2. Encouraging another person to deal in securities that are (whether or not that other person knows it) price-effected securities in relation to the information. 3. The disclosure of insider information to someone else for reasons not related to the proper performance of the functions of his employment, office, or profession.

This theory does not develop full solutions to the problematic process resulting from the dealing of shares based on insider information because most legislation did not organize civil liability through private articles, which calls for resorting to some general rules to understand the basis of this responsibility. Several theories have emerged in this regard. For example, in the UK regulations, there are civil rights for actions that violate legal duty through a tort action according to *Chase*⁵⁹⁹ *Manhattan Equities Ltd v Goodman*⁶⁰⁰

The right of ‘action damages’ can be set when a person suffers a loss due to the breach of a rule by an authorized person. FSAM 2000 S.150 (278) gives normal people the right to recover a loss by demonstrating.⁶⁰¹ As previously mentioned, in the absence of statutes to rectify a breach of legal duty, tort law can remedy certain insider trading situations, such as when a fraudulent or negligent announcement has been made that motivates a person to trade in such

⁵⁹⁶ Tanya Aplin and others, *Gurry on Breach of Confidence: The Protection of Confidential Information* (OUP Oxford 2012) P113.

⁵⁹⁷ Article 50 of the Saudi capital Market Law (2003)

⁵⁹⁸ British Criminal Justice Act of 1993, Article 52 ,53.

⁵⁹⁹ *Equities Ltd v Goodman and others* [1991].

⁶⁰⁰ Brazier (n 522). PP1,15.

⁶⁰¹ Financial Services Act 2012: Chapter 21, Explanatory Notes.

a way as to inflict a loss upon him. It could be envisioned in such circumstances that it is incumbent upon the insider to disclose all related information. However, in cases of failure to disclose information or where there is no obligatory disclosure or no duty of supervision to the claimant, the insider in such cases does not have legal responsibility.⁶⁰²

However, under sharia law, the mechanisms tend to differ from those available in common law systems, the available mechanism is taghreer ("misrepresentation"), Such trading also breaches the provisions of Capital Market Law for any person to trade based on inside information. it can be argued, therefore, that the Saudi legislature has gone some way to oblige market traders to disclose inside information to the other contracting party before a deal; otherwise, the trader must refrain from dealing by mechanism by *ghabn* or *ghubn* (misrepresentation).⁶⁰³ This refers to the relationship between dealers. The relationship between the company and a client is a fiduciary duty towards the company, which requires the trader not to exploit the company's funds for his personal benefit, and not to give priority to his own interest over the interest of the company.

Nevertheless, there is administrative sanction. First of all, administrative sanctions are generally the simplest to apply and the slightest severe compared with criminal and civil sanctions. Moreover, most of administrative sanctions are nonmonetary. In the Saudi stock market, administrative penalties such as warning, compensation of persons who have suffered damage as a result of the offense, or compel the offender to pay objectionable gains and other administrative penalties. Such sanctions do not reach the objective of discouraging deterring the insider trading, but in the case of brokers. For instance, the broker might lose his license which consider extremely serious sanction. Otherwise, the effectiveness of these sanctions anti inside traders is nothing. Which It will be discussed in detail in chapter six.

It has been concluded that above civil law and common law remedies are not sufficient to deterring others from engaging in such activities, these remedies may be useful to restore what the injured party lost. therefore, to regulate insider trading it should be a more reasonable objective would also include prevention as well as compensation.

⁶⁰² Rider and Ashe (n 552).

⁶⁰³ Gharar: can be defined as excessive or intolerable uncertainty or ambiguity in contracts. Linguistically, it has meaning of something likeable in appearance, but distasteful in reality. See Ahcene Lahsasna, A Mini Guide to Islamic Contracts in Financial Services (CERT Publications Sdn Bhd 2012).

4.7 Available Defenses/Exemptions against Insider Trading

Insider trading act can be found to be in violation of insider trading regulations or considered legitimate, subject on the circumstances and conditions. A number of situations are considered to be exempt from insider trading regulations. These defenses purpose at offering a protection against the abuse of prosecuting investor who breach the rules but who have a reasonable excuse for doing so. In conclusion, these kinds of defenses aim protection for investor. Moreover, the purpose behind such immunities is the that the implementation of these regulations depends deeply on the circumstances of these act.

According to the CJA 1993, defences are divided into two categories: 1) general defences, which are contained in Section 53, and 2) special defences, as stated in Schedule 1, in which the prohibitions against disclosing information, dealing and encouraging dealing do not apply. However, the burden of proof is on the defence in each case.⁶⁰⁴

Defences concerning dealing and encouraging offence: When an individual is dealing in securities or encouraging another, he will not be considered guilty of insider trading if he was not at that time involved in trading leading to profit because of the fact that the information in question was related to price sensitive information with respect to securities.⁶⁰⁵ Moreover, if an individual "At the time he believed on reasonable grounds that the information had been or would be disclosed widely enough to ensure that none of those taking part in the dealing would be prejudiced by not having the information" or "that he would have done what he did even if he had not had the information".⁶⁰⁶ Moreover, "Chinese Walls" are considered a legal defense and include situations where an insider can prove that, because of Chinese Walls in the firm, it was difficult for him to get the information in demand.⁶⁰⁷

'Dealing' and 'encouraging' are the only offences for which the 'special defences' stated in Schedule 1 can be implemented. However, these defences also protect 'market information' and 'market makers' as they conduct their business. The market information defence is

⁶⁰⁴ CJA 1993.s 53.

⁶⁰⁵ *ibid.*

⁶⁰⁶ *ibid.*

⁶⁰⁷ H Nejat Seyhun, 'Insider Trading and the Effectiveness of Chinese Walls in Securities Firms' (2007) 4 *JL Econ & Pol'y* P369.

contained in paragraph 2 of Schedule 1 of the CJA 1993.⁶⁰⁸

As mentioned earlier, with civil liability based on a breach of an obligation of contract, or illegal act, the burden of proving liability belongs to the plaintiff, who is either the public prosecutor, the other contracting party, or the company. In this case, it is necessary to prove that the trader used internal company information to buy or sell the stock.⁶⁰⁹ In the UK, the plaintiff must prove that a trader has taken advantage of inside information beyond a reasonable doubt. The defendant can deny responsibility for his actions. According to UK legislation, where there is no conclusive evidence to deny responsibility, the trader must prove that he used inside information to achieve a legitimate purpose.⁶¹⁰

Saudi legislation makes allowance for special reasons to avoid responsibility in the case of trading based on inside information along the same lines as in the UK legislation, according to the provisions of Article (53) of the UK's Criminal Justice Act, these special reasons include the exploitation of information in the deal, and the encouragement of third parties to handle or disclose information. Reasons for the denial of responsibility, in accordance with the UK legislation, according to the provisions of Article (53), include not expecting to make a profit or avoid a loss, and the belief that information was widely available before trading or encouraging third parties to trade.⁶¹¹

4.8 Enforcement Mechanisms

In order to ensure safety regulations are effectively imposed and enforced, there are two towers of strength which provide the basis to all companies. Firstly, the characteristics and strength of the regulator and, secondly, the overall competence of the courts. As a result of the high financial cost that private enforcement must tolerate, typically, safety laws bring in a public enforcer. For example, in America the SEC. Landis (1938) was the earliest to contend that the principle advantage of safety laws is the formation of a public enforcer.⁶¹²

⁶⁰⁸ Miles Stuart Speedie, 'The New Insider Trading Provisions' (1994) P185.

⁶⁰⁹ Rodman Ward and others, *Folk on the Delaware General Corporation Law* (Aspen Law & Business 2006) vol 2 P114.

⁶¹⁰ Naylor (n 574).

⁶¹¹ Criminal Justice Act 1993, Article 53.

⁶¹² Florencio Lopez-de-Silanes and others, *A Survey of Securities Laws and Enforcement* (World Bank Washington, DC 2004) P4.

In order to thoroughly gain an awareness of regulators and supervisors, specific topics must be addressed. Firstly, the key and primary element of a market supervisor is that it ought to be isolated and separate from political persuasions. To evade political influences, it should not come under the responsibility of the executive. Secondly, another crucial element of the supervisor is its overall control and strength. There are 3 chief powers which are typically assumed: the power to regulate, the power to sanction misbehavior and the power to investigate.⁶¹³

Three chief techniques can be adopted to identify insider dealing. These are whistle blowing, market surveillance and supervision. In Britain, 'supervision' involves members who are subject to FSA authority and there is no structured system of supervision conducted. This system does not involve unauthorized associates of corporations which cover up transaction accounts.⁶¹⁴

The singular method for identifying insider trading with this specific system is via internal compliance measures in authorized corporations. A second device is market surveillance and investigation. Although, frequently, stock market is incredibly private in relation to highlighting the nature of their organization's processes. In order to identify any strange or suspicious transactions within the market in the Saudi, electronic market observation devices are utilized. Although, as a result of the purpose of these devices, they are not obtainable to the public. Thirdly, whistle blowing is an additional device which is trailed by the FSA to identify insider trading. However, it is not as efficient as the SEC as it has the permission to pay abundances to all informers – only excluding informers who are purely conducting their job, for example obedience officers. This inducement was deliberated in the Criminal Justice Act declaration procedure but it was finalized that the inducement was "too American" to be seriously utilized.⁶¹⁵

⁶¹³ Wilson Andis, 'The Administrative Process' (1938) PP12,14 .

⁶¹⁴ Michael Filby, 'The Enforcement of Insider trading under the Financial Services and Market Act 2000' [2003] P334.

⁶¹⁵ The FSA rule of whistleblowing is "... based on the Public Interest Disclosure Act, PIDA 1998, which was passed in order to offer protection for employees who report matters of public interest from victimization by their employers. "W6 The FSA encourages whistle-blowers to come forward in the following matters: "(a) a criminal offense; (b) a failure to comply with any legal obligation; (c) a miscarriage of justice; (d) the putting of health and safety of any individual in danger; (e) damage to the environment; (f) deliberate concealment relating to any of the above.

IT surveillance schemes are the principle method for detecting insider trading transactions. Saudi market has not implemented whistle blowing as a scheme of enforcement, as the end will harmfully affect the effectiveness of enforcement in market. The nature of Saudi market is not available. consequently, an appropriate assessment of its effectiveness is not achievable. Lastly, what is most crucial is that there is a setting constructed which enables representatives, stockholders or depositors to understand that insider trading laws and regulations are strictly imposed and will have penalties if not abided by.

4.8.1 Enforcement Process

The appropriate strengths for implementing and inspecting insider trading defilements will be addressed and explored in the upcoming paragraphs. The crucial elements for the efficient implementation of enforcement methods are the levels of control and given powers to the stock market authorities to investigate violations. Insider trading laws and regulations would be considerably destabilized with the absence of operational examination powers. In Britain, the FSA is allowed huge exploratory power and control in relation to insider trading. They are able to investigate and demand data and information from any individual who is associated to or connected with the investigation.

The FSA's singular obligation is that they present the occurrence of "circumstances suggesting" that market abuse has been conducted. In comparison to the assessment recommended by Parliament which necessitates simply "reasonable grounds to suggest", this test is substantially less authoritative.⁶¹⁶ It can request for a permit which enables a constable, typically escorted by an FSA officer, to hunt and examine the property. The constable has the power to request any individual on the property to clarify documents or data they have uncovered. The FSA's control and power is supported by the regulations that failing to comply, interfering or destroying evidence, or providing incorrect data or information is categorized as an illegal act and is punished via a fine, a prison sentence or both.⁶¹⁷

One feature that arbitration committee in Saudi stock market must, if the dispute contains a criminal offence, refer the issue to the public prosecutor (Bureau of Investigation and

⁶¹⁶ Filby (n 610).

⁶¹⁷ *ibid.*

Prosecution).⁶¹⁸ Essentially, this ought to be altered and the physical control and powers must be thorough and documented correctly, as, currently, this committee is unable to carry out an investigation on the supposed individual's property.

Finally, The Saudi capital Market Law (2003) grant CRSD (Committee for the Resolution of Securities Disputes) powers to investigate and settle complaints and suits. Grant CRSD the power to issue subpoenas and necessary decisions to resolve the suit. Also, The Capital Market Law grant CRSD the power to impose sanctions moreover, it has the power to order the presentation of evidences and documents, and CRSD the power to issue a decision awarding damages. furthermore, Grant CRSD the power to issue a decision awarding damages.⁶¹⁹

4.8.2 Enforcement Obstacles

There are a series of obstacles and restrictions which can impede on the effectiveness of insider trading rules inside Saudi market. Firstly, a key restriction is social. Tipping is classified as a social duty and responsibility and insiders are underneath a huge level of social pressure to confidentially divulge any delicate private data and evidence. The financial literature does not contain many investigations about the impact of beliefs, social rules and values, despite the fact that it is logical to deduce that people behave differently in different social environments. It is individuals rather than markets who engage in decision-making, resulting in an interplay of individual preferences, organisational culture and social rules.

Prior research suggests links between individual religiosity and risk aversion. For ex-ample, Miller and Hoffmann report a negative correlation at an individual level between religiosity and attitude towards risk⁶²⁰. Similarly, Osoba utilises individual panel data to show that risk-averse individuals attend church more often than risk-seeking individuals⁶²¹. Hillary and

⁶¹⁸ Royal Decree No. M/56, 24 Shawwal 1409 (29 May 1989): The Bureau of Investigation and Public Prosecution

⁶¹⁹ 'Committee for the Resolution of Securities Disputes (CRSD)' (2016) <<http://www.crsd.org.sa/En/Dispute/Pages/AboutMOC.aspx>> accessed 8 April 2017.

⁶²⁰ RE Hoffman and others, 'Comparison of Partner Notification at Anonymous and Confidential HIV Test Sites in Colorado.' (1995) 8 J Acquir Immune Defic Syndr Hum Retrovirol 406.

⁶²¹ 'Osoba B. (2003). "Risk Preferences and the Practice. <https://scholar.google.com/scholar?hl=en&as_sdt=0%2C5&q=Osoba+B.+%282003%29.+%22Risk+Preferences+and+the+Practice+of+Religion%3A+Evidence+from+Panel+Data&btnG=>> accessed 22 February 2018.

Hui⁶²² examine whether religion affects corporate behaviour in the US, and subsequently found that firms located in counties with a higher level of religiosity display lower degrees of risk exposure.⁶²³ Organisational investment decisions (e.g. pension plans, general corporate decision-making) have been recognised in the wider literature to be influenced by religiosity and social rules to a certain extent.

The purpose of the present study is to explore the impact of social environments and religion on financial markets, thus producing new insight into this topic. More specifically, the study is concerned with the religion of Islam and investigates how ethical norms affect stock markets. Individual investment choices are subject to a number of restrictions under Islam, particularly interdiction of investment in publicly traded companies associated with, among others, alcohol and tobacco production and gaming ('sin stocks'), as well as in securities that accrue interest. Thus, the formulated hypothesis is that the portfolio choice of stocks is impacted in countries where individual codes of conduct and social rules are determined to a great extent by religion⁶²⁴.

Saudi Arabia is one country where religion – a highly strict form of Islam – holds a dominant influence in society, and where the majority of the population (97%) are Muslims. For these reasons, Saudi Arabia is the context chosen to examine whether ethical norms affect markets. Since the holy cities of Makkah and Medina are located on its territory, Saudi Arabia has a pivotal role within the Muslim world, which significantly shapes its identity as a country. Islamic financial services have experienced great growth in Saudi Arabia, but the market also contains stocks that do not comply with Sharia'a and trading in securities that comply with Sharia'a is not a legal obligation. As such, it is up to market players to make portfolio choices and market-makers' ethics determine moral obligations⁶²⁵.

Compared to other stock markets in emerging economies, the Saudi stock market stands out due to the manner in which it developed and the specificities of the Saudi economy. In recent times, there has been a substantial increase in market capitalisation and trading volume, but

⁶²² Gilles Hilary and Kai Wai Hui, 'Does Religion Matter in Corporate Decision Making in America?' (2009) 93 *Journal of Financial Economics* 455.

⁶²³ Alessandra Canepa and Abdullah Ibnrubbian, 'Does Faith Move Stock Markets? Evidence from Saudi Arabia' (2014) 54 *The Quarterly Review of Economics and Finance* 538.

⁶²⁴ *ibid.*

⁶²⁵ *ibid.*

most investors are not institutional but individuals. Moreover, only a minor percentage of buy and sell transactions are undertaken by nationals of countries of the Gulf Cooperation Council (GCC) and other Arab residents, while the percentage of transactions by non-Arabs is almost null. Consequently, foreign investment is extremely low⁶²⁶.

A short introduction to various aspects of Saudi society is provided in the following part in order to demonstrate the major influence of Islam and thus justify the choice of Saudi Arabia as the research context⁶²⁷. Politics: Saudi Arabia is an Islamic monarchy ruled by Islamic law and with the Qur'an as the constitution, as promulgated by the 1992 Basic Law of Government. Many governmental sectors, including the judiciary, education and scientific research, are under the control of religious scholars⁶²⁸.

Education: In Saudi Arabia, education is focused primarily on Islamic studies. At every school level, the curriculum emphasises the study of Islamic religion and learning how to apply Islamic customs in daily life. Furthermore, all students in higher education must take a religion course. Cuisine: Islam also determines what people can and cannot eat; thus, pork is banned, while Islamic rules must be followed in the slaughter of other animals. The drinking of alcohol is not permitted either. Culture: Social behaviour is also subject to restrictions and there is rigid legal and social enforcement of dress code⁶²⁹.

The aspects discussed above make it obvious that Saudi society and social interactions are significantly shaped by religion. The social researcher can take advantage of the sectarian nature of Saudi society and the latest transformations in the Saudi stock market to explore a phenomenon in a near-laboratory experiment. This gives rise to questions such as whether the characteristics of the social environment contribute to stock market volatility and whether it has any market effects on the effectiveness of insider trading rules.

⁶²⁶ *ibid.*

⁶²⁷ Saudi Arabia's New Basic Laws: The Struggle for Participatory Islamic Government - (1993) <https://scholar.google.com/scholar?hl=en&as_sdt=0%2C5&q=%5BCITATION%5D+Saudi+Arabia%27s+New+Basic+Laws%3A+The+Struggle+for+Participatory+Islamic+Government&btnG=>> accessed 22 February 2018.

⁶²⁸ Vogel (n 243).

⁶²⁹ *ibid.*

In fact, there was no significant difference between the peoples of the GCC countries, they combine all of these one religion and one language, customs and traditions are similar or convergent, also geographically. There is a study supports the point mentioned above, but it is concerned with the study of the Kuwaiti market, Emirates and Bahrain “For example, more than 65% of traders in the Kuwait Stock Market stated that they believe it is their social responsibility to tell friends and relatives of any inside information they possess. The same situation can be found in both the Dubai and Abu-Dhabi stock market: in Dubai, 55% of traders stated that they believe disclosing information is a social responsibility, and in Abu-Dhabi, 68% did so. In Bahrain, 60% of traders said that they believed it is their "social responsibility" to disclose any inside information.”⁶³⁰ The same obstacle can be drawn to more advanced countries. For instance, in his course of examining and discussing insider trading laws in the United States, the French lawyer Andre Tunc stated that:

"We did not do anything against insider trading until 1967, when we decided to fight it by borrowing your classical weapon against improprieties disclosure. We were very clumsy in using it, however, and we completely failed... in conformity with our style of legislation, the crime was defined and punishment provided in a single sentence of twenty-nine lines -- in contrast to the British Companies Act 1980. Obviously, it is impossible to eradicate improper insider trading and tipping in a decade in a country where such activities were a tradition on the part of the most respectable directors and officers, and where tipping was even a social duty, being expected of relatives and friends "⁶³¹.

Islamic law explicitly prohibits *fasad* and fraud. Compliance is ensured not so much by direct enforcement of the law, but by social pressure exerted by periodic sermons, reminders and admonitions by religious authorities via different media (e.g. television, radio, newspapers)⁶³².

Secondly, an additional restriction is the judge’s method in relation to applying insider-training laws and regulations. In financial illegal circumstances or “white collar crimes”, the judge has

⁶³⁰ Fahad Al-Zumai, ‘Protection of Investor in Gulf Cooperation Council Stock market: A Case Study of Kuwait, Bahrain and United Arab Emirates’ (School of Oriental and African Studies (University of London) 2006) P226.

⁶³¹ André Tunc and Andre Tunc, ‘A French Lawyer Looks at American Corporation Law and Securities Regulation’ (1982) 130 University of Pennsylvania Law Review 757.

⁶³² Rodney Wilson, ‘Review of Islamic Law and Finance: Religion, Risk and Return’ (1998) 13 Arab Law Quarterly 423.

typically shown a level of compassion for individuals who have been exposed to the severities of the standard criminal justice schemes. An insider trader in Britain, commonly known as Roger the Dodger, was sentenced to 180 hours of community service following him generating a 34-million-pound crash.⁶³³

If this is the circumstance in well-developed countries it is a fortiori, In Saudi, where stock market is relatively new to the area, the methods and situations are significantly worse than the systems which have been outlined in well-developed countries such as Britain. When discussing crime in Saudi, it is important to acknowledge that the idea of a crime standing with the absence of an unswerving victim is still considerably under developed. This is particularly relevant for crimes relating to finance as they are often victimless and, consequently, the judges are unwilling to enforce custodial sentences.

The notion that the market is a secure environment is considerably destabilized as a result of these areas being majorly under developed. Lastly, a major restriction is that the judges, typically, are missing a general awareness and education on these crimes. However, it is important to acknowledge that this is not relevant only to Saudi, the UK has also experienced similar restrictions. For example, in Britain, the Lord Chancellor is given the power to employ the personnel of the Tribunal, by Schedule 13 to FSMA 2000. However, it is compulsory that these employees are lawyers with the minimum of seven years of general qualification.

Additionally, a minimum of ten years of general qualifications or equivalent must be held by the President and the Deputy of the Tribunal. Furthermore, the Lord Chancellor must "... also appoint members of a lay panel, who must be people who appear to him to be qualified by experience or otherwise to deal with matters of the kind that may be referred to the tribunal...".⁶³⁴ These necessities which guarantee efficient and successful implementation are not accessible to Saudis' securities laws and insider training, which, eventually, weakens the implementation of laws and regulations throughout Saudi stock market.

⁶³³ Rider (n 581).

⁶³⁴ Loretta Minghella and Michael C Blair, *Blackstone's Guide to the Financial Services & Market Act 2000* (Blackstone 2001) P131.

4.9 Conclusion

This chapter examined the existing legal framework for the Saudi regulations of insider trading compared with those used in UK from investor protection perspective. Important issues were identified that must be addressed to deal effectively with insider trading: defining the activity, sanctions, and enforcing civil or criminal liability and enforcement mechanisms.

The term insider trading has been used in different spheres and has been examined from several aspects. The economic concept focuses mainly on trading that is based on an imbalance of information. The legal concept reinforces this belief.

Three elements are required for insider trading to take place: an insider, insider information and a transaction based on this information. In addition, the insider must be aware that the information obtained is inside information and must also have benefited personally from use of the inside information.

The definition of insider information, as well as the four criteria that determine whether insider information will have a significant effect on the security traded with regard to market price. Three transaction features should be considered with regard to inside information.

The classification of an insider trading offence relies on the characteristics of the offence, the standard of proof, the type and purpose of sanction and the prosecution procedures. There are four prohibitions when inside information has been acquired: dealing, gaining benefit, encouraging others to benefit from the inside information, and disclosing the inside information. Once these prohibitions have been violated, an insider trading offence has been committed.

Insider trading is regulated by legislation in both Saudi Arabia and the UK. In Saudi Arabia, regulations is embodied by the CMA Act and market conduct regulations, whereas in the UK, the Financial Services and Market Act (FSMA) the Criminal Justice Act (CJA) and EU directives underpin regulations, these play an important role. However, the way that insider trading is treated in different legislative frameworks has created some confusion as to whether the offence should be classified as civil, administrative or criminal.

The person affected by insider trading must resort to the law by filing a lawsuit requesting compensation. Any request for compensation is subject to the general rules of litigation. Neither Saudi nor UK legislation includes any special provisions for civil liability arising from inside trading information. Responsibility for this is subject to the general rules. It is advisable to organise special measures to encourage the dissemination of any information that could have a substantial effect on stock prices. Inside information tends to be exploited due to its confidentiality. Public dissemination of such information can prevent the temptation to exploit its use.

In Saudi Arabia, a number of reasons can be invoked to invalidate action in lawsuits dealing with outlawed shares of public joint-stock companies. These include breach of a legal obligation, breach of the duty of honesty, truthfulness and the disclosure of confidential information or trade secrets. With regard to lawsuits dealing with trading based on inside information, reasons that invalidate action include breach of legal statutory misrepresentation, breach of fiduciary duty and breach of confidence and/or trade secrets. In the UK, Breach of fiduciary duty can be applied to the relationship between a company and a member of its board of directors.

In the Saudi stock market, Administrative sanctions are generally the simplest to apply and the slightest severe compared with criminal and civil sanctions. Moreover, most of administrative sanctions are nonmonetary. Such sanctions do not reach the objective of discouraging deterring the insider trading. It has been concluded that civil law and common law remedies are not sufficient to deterring others from engaging in such activities, these remedies may be useful to restore what the injured party lost. therefore, to regulate insider trading it should be a more reasonable objective would also include prevention as well as compensation.

The lack of effective investigatory authorities, which obstructs the capability of the Saudi stock market to increase enforcement. Consequently, it is necessary to ensure that these authorities have the required powers to enhance enforcement, which will lead and encouraging improved investor confidence and the growth of the stock market

There are a series of obstacles and restrictions which can impede on the effectiveness of insider trading rules inside Saudi market. Firstly, social obstacle can deter the effectiveness of insider trading rules in Saudi markets, which is tipping that considered a social responsibility, and

insiders are under social pressure to confidentially disclose any sensitive non-public information.

Secondly, an additional restriction is the judge's approach in relation to applying insider-training laws and regulations. When reviewing crime in Saudi, it is important to acknowledge that the idea of a crime established with the absence of an unswerving victim is still considerably under developed. This is particularly relevant for crimes relating to finance as they are often victimless and, accordingly, the judges are unwilling to enforce jail sentences. as well as that, a main restriction is that the judges, usually, are missing a general awareness and education on these crimes.

Chapter 5: A Framework for the Analysis of Market Manipulation in Saudi Stock Market

5.1 Introduction

One of the biggest concerns of investor in today's securities market is market manipulation. As mentioned in the first chapter that there are many practices that affect and harm the integrity of Saudi stock market. Which led to the collapse of 2006, one of These practices is "Market manipulation".⁶³⁵ Therefore, market manipulation is harmful to the integrity of the stock market when a trader alters trading volumes, which causes trades to directly affect the prices and quantities of securities traded in the market, market values of those securities are adversely expected.⁶³⁶ Consequently, the public loses confidence in the stock market's remaining investor who lose more financial resources putting them at an unfair disadvantage. The result devolves the stock market turns into a legal casino. Thus, the primary purpose of market manipulation regulations is to provide basic investor protection from fraud and misleading and to protect investors' confidence.

However, Market manipulation is a poorly understood phenomenon, due in part to legal standards that categorize manipulative behaviour as either an act of outright fraud or the nebulous use of market power to produce an artificial price. This chapter's main objectives are to define market manipulation and elucidate its common forms. The aim of this is to discover how well the law covers the most common forms of market manipulation as defined in the chapter and in comparison with the UK's approach to regulating market manipulation under the FSMA 2000. Moreover, the chapter examines the current system of controlling market

⁶³⁵ The perception that market manipulation is present in the Saudi stock market is widespread amongst Saudi traders and investors. Although there is no substantial evidence to support this view, it is a strong perception. The idea has emerged from chatrooms, newspapers and some companies' financial reports. Reaching an accurate conclusion on whether the Saudi stock market is actually suffering from market manipulation behaviour is difficult because no practical or statistical studies have been conducted on this topic. However, the lack of evidence concerning market manipulation does not eliminate the importance of identifying the Regulations of market manipulation, as such practice may have a strong effect on the Saudi stock market.

⁶³⁶ Douglas Cumming and others, 'Exchange Trading Rules and Stock Market Liquidity' (2011) 99 Journal of Financial Economics P651.

manipulation in Saudi Arabia to assess whether it is adequate for the intended purpose in aspect of investor protection.

Many researchers in this field refer to the manipulation that was happening in the financial market of Amsterdam: Among the plays which men perform in taking different parts in this magnificent world theatre, the greatest comedy is played at the Exchange. There, ... the speculators excel in tricks, they do business and find excuses wherein hiding places, concealment of facts, quarrels, provocations, mockery, idle talk, violent desires, collusion, artful deception, betrayals, cheatings, and even tragic end are to be found
-- Joseph de la Vega (1688), describing the Amsterdam Stock Exchange.⁶³⁷

Among the most famous cases of manipulation that led to the enactment of systems and institutions used today was the complicity of groups of traders (investment banks, market makers, and company executives) to raise prices on the New York Stock market in what became known as the *complicity of the stock (stock pool)*. It resulted in the enactment of the *Securities Exchange Act* in 1933, followed by laws regulating the financial market and the establishment of the Capital Market Authority in 1934.⁶³⁸

investors' confidence in the fairness and transparency of the market enhances its liquidity and efficiency, thereby promoting equality in market transactions, strengthening confidence in it and helping ensure adequate and sustained funding of the institutions listed on the stock market. This will in turn lead to increased exchanges in the market, resulting in an increased rate of economic growth. However, market manipulation damages the integrity of market, and thus weakens investor confidence in it. Accordingly, authorities around the world need to have adequate systems in place to detect, investigate and prosecute market manipulation, which will prevent illegal practices within the stock market, to protect investor and ensure durability and make market immune to financial crises.

⁶³⁷ Tālis J Putniņš, 'Market Manipulation: A Survey' (2012) 26 *Journal of Economic Surveys* 952.

⁶³⁸ Franklin Allen and Douglas Gale, 'Stock-Price Manipulation' (1992) 5 *Review of financial studies* P503.

5.2 Definition of Market Manipulation

The term market manipulation was described as ‘a term of art’ by the US Supreme Court.⁶³⁹ This indicates how difficult it is to describe the term *market manipulation* in one all-encompassing definition. Defining manipulation is no simple task. Many attempts have been made to define this term by judicial, jurisprudential and regulatory bodies, but the results are still unsatisfactory in both the legal and economic literature. As the word *manipulation* has changeable meanings, it could be expanded to include numerous of practices or restricted to a limited action.⁶⁴⁰ In addition, market manipulation is associated with different types of behaviour and activities, which make defining the term even more difficult, as presented in this chapter.

5.2.1 The Jurisprudential Approach

A number of attempts have been made to define market manipulation by academics. One definition of market manipulation is ‘deliberate interference with the free play of supply and demand in the securities markets’.⁶⁴¹ Another possible definition is ‘where someone seeks to distort the price of financial instruments, or effect transactions or orders to trade or disseminate information in a manner that gives or is likely to give false or misleading signals about financial instruments’.⁶⁴²

A final definition of market manipulation is ‘conduct intended to induce people to trade a security or force its price to an artificial level’.⁶⁴³ The first and second definitions given above are more applicable, because the second definition is a general definition, while the first and second definitions are comprehensive and give methods by which market manipulation occurs.

⁶³⁹ Santa Fe Industries, Inc v Green (1977) 430 US 462, 477.

⁶⁴⁰ Robert A Jarrow, ‘Market Manipulation, Bubbles, Corners, and Short Squeezes’ (1992) 27 Journal of financial and Quantitative Analysis 311.

⁶⁴¹ Bernd H Klose, Asset Tracing & Recovery: The FraudNet World Compendium (Erich Schmidt Verlag GmbH & Co KG 2009) P9.

⁶⁴² ‘FSMA Market Abuse Regime: A Review of the Sunset Clauses - Lexology’ (2008) <<http://www.lexology.com/library/detail.aspx?g=26a6d941-7e69-427d-a271-f3a20b6a36cf>> accessed 8 April 2017.

⁶⁴³ ‘Market Manipulation Law’ (2002) 1 The Ministry of Economic Development Reform of Securities Trading Law P15.

Avgouleas' definition of manipulation includes the main features that are missing features from the abovementioned definitions. According to this author, manipulation can be defined as follows:

'Behaviour effected through any one, or a combination of any of the following: misrepresentations and other false statements or concealments, artificial transactions and trading schemes, which are made or structured in such a way as to induce market participants to engage in the trading of financial investments or the exercise of rights in financial investments. Relevant trading must be in such a direction or the exercise of rights must be effected in such a way as to either lead the price of these investments to an artificial level, and/or enable the perpetrators of the behaviour to materialize, from interests held in the specific or related investments, financial gains that would not be possible, in the absence of such behaviour'.⁶⁴⁴

This definition is more organised than the previous ones; moreover, it includes the most important components of manipulation, such as intent, measurement of manipulation and manipulative practices. However, this definition still has some important gaps, as it does not mention the 'artificial level' or 'artificial transactions'. These definitions can be divided into three main categories according to their core characteristics. The first is that market manipulation occurs if trading interferes with the laws of supply and demand. The second is that manipulation takes place if it 'induce(s) people to trade'. Finally, if a trade's purpose is to either increase or decrease a security price artificially, then it will be considered market manipulation.

These three categories might be restricted to two categories, as interfering with supply and demand would simultaneously encourage others to trade while creating an artificial price.⁶⁴⁵ Therefore, it is beneficial to consider each of the following remaining categories: (1) creating artificial prices and (2) the intent of inducing others to trade.

⁶⁴⁴ Avgouleas and others (n 473).

⁶⁴⁵ Daniel R Fischel and David J Ross, 'Should the Law Prohibit "Manipulation" in Financial Markets?' (1991) 105 Harvard Law Review P503.

5.2.2 The Legal Concept of Manipulation

“Professor Loss, invariably described as the Father of modern securities law, has noted that manipulation is ‘related to the field of fraud – but not altogether a part of it as a matter of legal analysis’”.⁶⁴⁶

Laws forbidding manipulation generally define it as including the establishment of ‘artificial’ or ‘false’ market prices. Because of the absence of a legal definition of manipulation, there has been disagreement between the courts and commentators in its identification and description.⁶⁴⁷

Because of the lack of a clear legal definition of manipulation, some commentators, such as Fischel and Ross, demanded the law should not pay consider any sort of definition. They claimed that manipulation that does not ultimately succeed in changing prices because of symmetrical price pressure effects is non-fraudulent. Moreover, they concluded that manipulation should not be regulated, since manipulation is sure-to-lose, making it entirely self-detering.⁶⁴⁸

It is difficult to agree with Fischel and Ross, since manipulation that does not result in harm does not support their view that trade-based manipulation is unprofitable. Simply changing prices gives the average investor a reference price that reflects supply and demand. However, as mentioned above, it has been difficult to find a comprehensive definition of market manipulation. Therefore, it can be identified via some manipulative practices, such as ‘wash trading’, ‘pump and dump’ and ‘churning and burning’, which can be readily identifiable.⁶⁴⁹

The concept of market manipulation does not have to involve trading. It can include spreading false or misleading rumours about a company to increase or decrease the stock prices. However, there are concerns that regulators and lawmakers will confuse market manipulation with modern technology and the structure of stock market. The problem lies in the failure to differentiate between what is legitimate speculation and what constitutes manipulation, which

⁶⁴⁶ Loss and Seligman (n 538).

⁶⁴⁷ Vivien R Goldwasser, ‘Regulating Manipulation in Securities Markets: Historical Perspectives and Policy Rationales’ (1999) 5 *Austl J Legal Hist* P149.

⁶⁴⁸ Fischel and Ross (n 641).

⁶⁴⁹ Dionigi Gerace and others, ‘Stock Market Manipulation on the Hong Kong Stock Exchange’ (2014) 8 *Australasian Accounting Business & Finance Journal* P105.

is a testament to the competition for the smartest, fastest and most profitable. Thus, it is important for lawmakers and regulators to limit and prevent market manipulation without prejudice and allow the natural development of the market.⁶⁵⁰ The agreement opinion is that carefully targeted laws are required to effectively prosecute and prevent harmful market manipulation. Through changing a market's price formation and discovery process and victimising ordinary investor, market manipulation is commonly understood as having a harshly negative influence on market efficiency and integrity".⁶⁵¹

5.3 Forms of Market Manipulation

Although there is no clear definition of the term 'market manipulation', there are some common practices that are believed to be manipulative because they involve commonly occurring elements. These forms are classified as manipulation by analysts and commentators. While addressing these forms, many classifications of market manipulation become evident.⁶⁵² According to Allen and Gale⁶⁵³, there are three types of manipulation:⁶⁵⁴ Manipulation influencing value⁶⁵⁵, Manipulation influencing price through disseminating misleading information⁶⁵⁶ and Manipulation influencing price through trading volume.⁶⁵⁷

⁶⁵⁰ Albert S Kyle and S Viswanathan, 'How to Define Illegal Price Manipulation' (2008) 98 The American Economic Review P274.

⁶⁵¹ *ibid.*

⁶⁵² Fischel and Ross (n 641).

⁶⁵³ Allen and Gale (n 634).

⁶⁵⁴ *ibid.*

⁶⁵⁵ Occurs when a manipulator decides to affect the value of a share. This manipulation is often contributed to by a company's decision-makers. Examples of this type include decisions regarding mergers and acquisitions, such as an announcement of an offer to buy or merge with a company leading to a rise in the share price of the target company; the advertisers then sell their shares before announcing that negotiations have stalled.

⁶⁵⁶ Occurs when manipulators publish incorrect information or information that is correct but shown in a way that can be interpreted wrongly by others. This impacts other traders' expectations about the value, and enters into it, publishing (joint stock company) misleading information about its financial position, and do some analysts recommendation or give positive information to the shares they own. The rapid evolution of information technology, especially the Internet and mobile phones, had made it easy to disseminate misleading information.

⁶⁵⁷ Occurs when a trader causes trades to directly affect the prices and quantities of securities traded in the market, adversely affecting the expectations of the rest of the market of the values of those securities.

However, Avgouleas has created a clear division that includes many forms and practices, which is adopted in this section.⁶⁵⁸ He divided forms of market manipulation into the following three categories: (1) manipulation based on information, (2) manipulation based on artificial transactions and (3) price manipulation⁴³. Each of these categories will be addressed separately.

5.3.1 Information-Based Manipulation

The first form of market manipulation is information-based manipulation. There are two main approaches in this form. First, manipulation occurs through broker misrepresentations and investment analysts' reports; second, it may be achieved through market manipulation and internet manipulation.⁶⁵⁹

The first mechanism takes place when broker or investment analysts give misrepresented information about specific securities in the market to obtain benefit for themselves. For instance, a broker may take a stock option and deliver misleading information about a certain security to increase the price of that and obtain an advantage. Moreover, if the broker owns shares, a conflict of interest will emerge. For illustration, a broker recommends that his client should buy a specific share; then, before advising others to buy it, the broker purchases this share for himself to take advantage of the increase in the price that occurs right after the broker's recommendation.⁶⁶⁰

The second mechanism that is regularly used in information-based manipulation is Internet manipulation involving the dissemination of incorrect information or rumours or the use of artificial transactions (discussed in detail in the next section). To change the price of the security through the Internet, text messages, email and so on may be used as means of market manipulation.⁶⁶¹ Market manipulations also included in this mechanism, as seen in the case of *R. v De Berenger In De Berenger*. Here, when Berenger falsely reported Napoleon's death, stockbrokers and the public were forced to buy into the government debt; as a result, Berenger and members of the syndicate gained their advantage.⁶⁶²

⁶⁵⁸ Avgouleas and others (n 473).

⁶⁵⁹ FSA Consultation Paper No. 10, "Market Abuse Part 1: (1998) Consultation on a Draft Code of Market Conduct".

⁶⁶⁰ Gordon De Brouwer, *Hedge Funds in Emerging Market* (Cambridge University Press 2001) P158.

⁶⁶¹ Avgouleas and others (n 473). P104.

⁶⁶² New Zealand Governance Centre (n 488).

This is important because information has a direct impact on the prices of securities and trading. One of the important elements used in determining stock prices is accurate information. Therefore, when information is inaccurate – for instance, because of the spread of rumours – prices are affected in a manipulative manner. Thus, manipulators spread rumours or false information to serve their own interests and to influence other investor.⁶⁶³

5.3.2 Manipulation Based on Artificial Transactions

The second category is called manipulation based on artificial transactions; Article I (2)(b) of the EU Market Abuse Directive and FSMA Section 118 give clear descriptions of such market activities.

This form of market manipulation is intended to create artificial transactions on a particular share, at a time when there is no real deal available. For example, an individual may have a certain number of shares, sell them nominally to a relative or friend, then buy them back in a short period of time – possibly on the same day. This is done to convince other traders that price changes have taken place for that share and discuss its activity.⁶⁶⁴ Such sales are also called ‘wash sales’, ‘matched orders’, or ‘pools’. However, the cornerstone of this kind of market manipulation is ‘fictitious trades’. To distinguish between legitimate transactions and artificial transactions.⁶⁶⁵

The concept of ‘matched orders’ is similar to that of ‘wash sales’. However, this kind of manipulation involves entering buy and sell orders at the same time identical to certain security. The aim of this plan is to give buy and sell orders to many brokers that do not know each other to create the impression that there is a great and renewed interest in these shares.⁶⁶⁶

Manipulative information can be given to newspapers and financial media, which then promote specific shares. If the manipulator begins to buy without selling, then the prices tend to climb,

⁶⁶³ Avgouleas and others (n 473).

⁶⁶⁴ Apostolos Ath Gkoutzinis, *Law and Practice of Liability Management: Debt Tender Offers, Exchange Offers, Bond Buybacks and Consent Solicitations in International Capital Market* (Cambridge University Press 2014) P128.

⁶⁶⁵ Eva Lomnicka, ‘Preventing and Controlling the Manipulation of Financial Markets: Towards a Definition of “Market Manipulation”’ (2001) 8 *Journal of Financial Crime* P297.

⁶⁶⁶ Philip McBride Johnson and Thomas Lee Hazen, *Derivatives Regulations: Successor Edition to Commodities Regulations* (Aspen Publishers Online 2004) P1311.

and this incites the public to purchase the shares. The prices will continue to rise until they reach a level that satisfies the ambitions of the manipulators, who will then sell these shares. The price does not decrease soon after the factors that brought it up are shifted; the manipulators may avail themselves of the opportunity of the deterioration in turning to the downward trend after they were speculating on the climb. The issue may be an agreement between a group of dealers – often written – to give authority to the director to trade in a particular stock during a certain period and distribute any profits among themselves or sharing losses if they occur; such agreements are called manipulation agreements (pools).⁶⁶⁷

5.3.3 Price Manipulation

There are three main mechanisms for price manipulation. These are ‘trade-based manipulation’, ‘contract-based manipulation’ and ‘market power manipulation’.⁶⁶⁸

5.3.3.1 Trade-Based Manipulation

This concept of this kind of manipulation is linked to the trading itself, whether buying or selling, carried out to materially affect the prices of the securities, driving them up or down to create an incorrect impression. This takes advantage of the assumption that there is a relationship between trading and price movements, since acquisitions increase the price of a security and auctions decrease its price. As a result, manipulator gains as a result of trade-based manipulation.⁶⁶⁹ In this case, there is a need to determine intent, because the intent of the manipulator must be to effect others by creating a misleading impression.

There are different forms of trade-based manipulation, such as trading at the end of the day, sale-based manipulation and purchase-based manipulation. The trading at the end of the day strategy is based on giving a misleading impression about the stock, whether to convince traders that price changes have taken place for the security or to give the impression that the security is active; this represents fraud and manipulation.⁶⁷⁰

⁶⁶⁷ The Ministry of Economic Development. Reform of Securities Trading Law. (2002). Market Manipulation Law. 2 (1), P15.

⁶⁶⁸ Avgouleas and others (n 473).

⁶⁶⁹ *ibid*, P. 132.

⁶⁷⁰ *ibid*, P. 137.

There are two different types of trade-based manipulation, namely purchase-based manipulation and sale-based manipulation; these can be seen as two sides of the same coin. The main objective of purchase-based manipulation is to ‘corner’ the market; this is also known as ‘market pegging’, and it serves to control the supply and demand of a certain security, then sell it at a price that suits the manipulator.⁶⁷¹ ‘Bull pools’ are another example of such a practice. In general, sale-based manipulation is based on the idea of selling a security to decrease its price to benefit from this lower price and purchase it at this price. The aim of this scenario is to profit from the price difference because selling gives a negative impression of a certain security, which leads traders to sell at lower prices.⁶⁷²

5.3.3.2 Contract-Based Manipulation

In contract-based manipulation, the manipulator benefits indirectly from a certain security indirectly; the aim is not to sell a security at a high price or buy at a low price but to take advantage of another contract or clause.⁶⁷³ For example, a corporate ‘office manager’ once attempted to increase the price of his company’s shares to ‘trigger a bonus clause in his compensation package based on the firm’s stock price’.⁶⁷⁴

5.3.3.3 Market Power Manipulation

The last form of price manipulation is market power manipulation. *Market power* can be seen as synonymous with *market monopoly*.⁶⁷⁵ In this type of manipulation, person or group buys a huge amount of certain financial papers for the purpose of attaining a monopoly; the group can then control the price and sell the shares in the market at a price that it sets.⁶⁷⁶ Moreover, the manipulator has the power to control the supply and demand of a certain security, then sell it at a desirable price.⁶⁷⁷

⁶⁷¹ *ibid*, P. 137.

⁶⁷² Fischel and Ross (n 641).

⁶⁷³ Andrew Verstein, ‘Benchmark Manipulation’ [2014] Browser Download This Paper P300.

⁶⁷⁴ Fischel and Ross (n 641).

⁶⁷⁵ This concept is borrowed from anti-trust laws.

⁶⁷⁶ “Bisha Agriculture Co. of Saudi Arabia is but one example. This increasing phenomenon is due to the low capital of new listed companies as they average from \$15 million to \$30 million which makes it easy for speculator to control the supply side of these shares.

⁶⁷⁷ Benjamin E Kozinn, ‘The Great Copper Caper: Is Market Manipulation Really a Problem in the Wake of the Sumitomo Debacle’ (2000) 69 Fordham L Rev 243.

Monopolies emerge in the commodities market in the same way as in the stock market, but as opposed to monopoly in the stock market, manipulation of the commodities market is legally forbidden. In the stock market, monopolies only become illegal if actions are carried out that are already prohibited conduct in the securities markets. In terms of market control, market power manipulation involves cases where an institution or individual controls the supply and demand of a certain security, which will empower the institution or individual to change the price according to identified interests.⁶⁷⁸

5.4 Relationship Between Market Manipulation and Protection of Investor

Whether natural supply and demand characteristics of the market are reflected in manipulative practices, or whether the prohibiting or control of market Manipulation should take place, are just two queries that may arise during the discussion of this topic. Below, it will be explained how the prohibiting of market manipulation is often viewed with much agreement in the literature. According to Barnes, ‘the price of a share is determined by supply and demand... Its price is... what an investor believes it is worth. A share price reflects all known information... of all investors’.⁶⁷⁹ The concept of market efficiency was mentioned above, with a deeper explanation of the principle provided below.

Conversely, market manipulation undermines this efficiency.⁶⁸⁰ Market manipulation will involve artificial transactions, so this might hinder supply and demand for instance. Moreover, presentation of honest and useful information is at odds with the action of spreading false information or circulating rumours. Therefore, supply and demand is regularly disregarded when a manipulators engaging in fraud seeks to affect share values through rumours, which is

⁶⁷⁸ Stephen Pirrong, *The Economics, Law, and Public Policy of Market Power Manipulation* (Springer Science & Business Media 2012) P16.

⁶⁷⁹ Paul Barnes, *Stock Market Efficiency, Insider Dealing and Market Abuse* (Gower Publishing, Ltd 2009).

⁶⁸⁰ One of the most important concepts of the efficient-market hypothesis addressed by financial and accounting studies was made clear by Fama: “It was generally believed that the securities market were extremely efficient in reflecting information about individual stocks and about the stock market as whole.” This EMH hypothesis includes information and pricing efficiency, in addition to operating efficiency. According to this theory, stock prices are efficient when they reflect the real values of shares because financial market whose primary objective is the allocation of financial resources to the most productive projects must be efficient if they are to optimally achieve their objectives. See Fama (n 84).

considered harmful to the growth and the integrity of any stock market.⁶⁸¹

Fundamentally, by reviewing forms of market manipulation, such as information-based manipulation, artificial transactions, and price manipulation, it can be concluding that the production of artificial values, pretend trades and false information results from market manipulation. Because the resulting trade does not reflect foundational financial principles, market efficiency declines. Just market practices should be seen as being undermined by market manipulation, because equal access to information and chance to assess it is necessary for every investor.⁶⁸²

Furthermore, honest and truthful resources, as well as their fair access, allow a strong trading arena to be created, otherwise this is undermined. The chance of large investments also decreases, as does liquidity, because there is weakens confidence regarding the market among investor if manipulation is occurring. All these damage resulting lack of growth of the stock market. Market failure and breakdown, which impacts upon the entire economy of a state or beyond, can also be a greater hazard when manipulation occurs. A state's economic situation is reflected in its stock market, which was explained previously. Consequently, many ordinary people stand to suffer from the activities of a few who abuse their positions to engage in manipulative practices.⁶⁸³

Positive market operation is undermined by manipulation of markets, therefore it requires improved legislation to enable proper operation, on the findings of the research. Essentially, financial markets' efficiency is at odds with the activities of artificial value shifts, transactions and misleading information that manipulation involves. Actual transactions and values that reflect a strong market are tied to greater transparency.⁶⁸⁴

Furthermore, rumours should not impact upon investors' knowledge, with sources that have a strong reputation providing trustworthy information. Conversely, manipulators often spread untrue information and create artificial dealings, which devastation the efficiency of a fair market. The transactions that traders undertake will be impacted on in an adverse manner by

⁶⁸¹ Lomnicka (n 661).

⁶⁸² Barnes (n 675).

⁶⁸³ Gkoutzinis (n 660).

⁶⁸⁴ Jarrow (n 636).

fake trades, rumours and untruths that can influence their choices, which is a further problem of manipulation of markets. Additionally, market Manipulation is harmful to the growth and the integrity of the stock market, because these manipulative practises reduce market efficiency and create artificial prices, which leading large economic downturns and collapse of market following bubbles.⁶⁸⁵

Nevertheless, the additional protection there is for investor within regulations, the stronger the market will be. Investors' fair and equitable access to precise data can assist with creating market efficiency, which is a situation that can be created through regulations against manipulation of markets. Ultimately, regulations is required for both disclosure and manipulation, if efficiency is to be promoted in markets. Misleading and untruthful information as a foundation of certain manipulative behaviour could be challenged through better release of information, although it is not the focus of this assessment. Market efficiency would then be improved through such measures. Furthermore, confidence typically increases in the market ,when supply and demand are in balance, which leads to improved stock market growth.

Whether investor themselves or the entire market should be the focus of safeguarding regulations is one question that requires answering, once policy makers realize the damage occurring from manipulation. Legislating against manipulation would be a means of ensuring that confidence in the market is achieved and will helped the growth of stock market. However, prohibiting manipulation may be at odds with the need to permit continued purchase and selling by investor, if regulations is implemented at an individual level.⁶⁸⁶

The unregulated market will be little different to this situation in terms of hazards. Consequently, manipulation should be regulated and prohibited, with appropriate trading systems adopted to protect the investor from manipulative practices. In summary, all investor should be able to have equal opportunities to use the information 'equal access to information, confidence in the public setting mechanism, and confidence that the public information is not false or misleading'. Regulations against manipulation of market could help to bring this

⁶⁸⁵ John Armour and others, 'Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis' (2009) 6 Journal of Empirical Legal Studies 343.

⁶⁸⁶ 'Market Manipulation Law' (2010) 1 The Ministry of Economic Development Reform of Securities Trading Law P15.

situation about.⁶⁸⁷

A small but growing number of theoretical studies have investigated the behaviour of manipulators and its impact on the efficiency of the market. According to Vila, who focused on pre-sale manipulation strategies, manipulators publish rumours aimed at lowering share prices, then buy later when the prices have gone down.⁶⁸⁸ Allen and Gale studied purchasing and sales manipulation; this type succeeds because of the contrasting information between traders about who is buying and whether they are familiar with the market and information or manipulators.⁶⁸⁹

Allen and Gorton argue that “[t]he natural asymmetry between liquidity purchases and liquidity sales gives rise to profitable trade-based manipulation. If liquidity motivated sales are more likely than liquidity motivated purchases, buy orders are more informed on average and therefore have a larger effect on prices.”⁶⁹⁰ Benabou and Laroque focused on cases of manipulation in which traders (such as financial analysts, market observers, and company insiders) declared expectations about future stock prices that did not agree with their assessments of the shares.⁶⁹¹ Van Bommel modelled the use of imprecise information to influence stock prices.⁶⁹²

"Jarrow⁶⁹³, Cherian and Kuriyan and Cherian and Jarrow⁶⁹⁴ build on the model of Hart and derive conditions under which trade-based manipulation is not possible. In Cherian and Kuriyan's model manipulation is not possible with rational agents when price responses are symmetric. Jarrow demonstrates that a sufficient condition to exclude market manipulation strategies is that the price response function depends only on a trader's aggregate stock holdings and not on his past sequence of trades, in other words, when prices do not exhibit

⁶⁸⁷ *ibid.*

⁶⁸⁸ Jean-Luc Vila, 'Simple Games of Market Manipulation' (1989) 29 *Economics Letters* 21.

⁶⁸⁹ Franklin Allen and Gary Gorton, 'Stock Price Manipulation, Market Microstructure and Asymmetric Information' (1992) 36 *European Economic Review* 624.

⁶⁹⁰ Putniņš (n 633).

⁶⁹¹ Roland Benabou and Guy Laroque, 'Using Privileged Information to Manipulate Markets: Insiders, Gurus, and Credibility' (1992) 107 *The Quarterly Journal of Economics* P921.

⁶⁹² Jos Van Bommel, 'Rumors' (2003) 58 *The Journal of Finance* P1499.

⁶⁹³ Jarrow (n 636).

⁶⁹⁴ *ibid.*

‘momentum’”.⁶⁹⁵ In his book on market manipulation, Avgouleas wrote second- and fourth-quarter summaries of economic theories related to manipulation and an economic analysis of the types of manipulations and their mechanisms.⁶⁹⁶

In Saudi Arabia, manipulation is based primarily on spreading misleading rumours and information about the earnings of a firm. After the recent financial crash, some 400 cases of manipulation were detected. Thirty cases went to court and many large investor were convicted, with one being imprisoned. This is clear evidence that the Saudi stock market was manipulated.⁶⁹⁷

5.5 The Catholic Marriage Between Internet and Market Manipulation

The Internet is one of the pillars of the technological era. It is considered one the most important methods of manipulation.⁶⁹⁸ The Internet has become an easy, low-cost way to broadcast information to huge numbers of people instantaneously.⁶⁹⁹ Security price manipulation can occur through fabricated information and rumors, which spread quickly through the the Internet. Varying degrees of such manipulation occur in both developing and developed markets, meaning it is a pervasive issue. One instance of this is when an innovative fingerprint identification programmed for credit card purchases was reported to have been developed by

⁶⁹⁵ Putniņš (n 633).

⁶⁹⁶ Avgouleas and others (n 473).

⁶⁹⁷ Samba Bank (2009).

⁶⁹⁸ Rydge and Comerton-Ford studied Australia’s financial market. They used cases under investigation or brought to trial from 1989 to 2002. They looked at 360 cases (or 28 per year), taking into account that the mechanisms for discovering manipulation improved with the passage of time. Their most important findings are as follows: Manipulation took place over 20- to 90-day periods. Better methods for detecting manipulation began appearing in 1997. The number of traders involved in cases of manipulation decreased from 10 to 4. This can be attributed to the widespread use of the Internet, which makes market manipulation easy for a small number of traders using multiple investment portfolios, nominally owned by different traders. Most manipulation depends on using price-raising strategies, followed by trading in large quantities and using price-reduction strategies. Most (80%) of those involved in the cases were executives, their associates, or major investor with ownership stakes ranging between 5% and 30%. Most (50%–80%) of the cases involved the use of strategies to increase prices in the last 20 minutes of the trading period. See James Rydge and Carole Comerton-Forde, ‘The Importance of Market Integrity’ [2004] Regulation.

⁶⁹⁹ Guolin Jiang and others, ‘Market Manipulation: A Comprehensive Study of Stock Pools’ (2005) 77 *Journal of Financial Economics* 147.

Comparator Systems Corporation (Comparator), via the National Association of Securities Dealers Automated Quotation System (NASDAQ). Such reports led to a \$1 billion market capitalization of the firm being seen over the course of a day, a tremendous rise from its previous \$36 million, while a \$0.03 to \$1.75 increase in the firm's share price also occurred.⁷⁰⁰ In Saudi Arabia, only a limited percentage shift in share value is possible due to intra-day trading limits on the market, meaning that such significant climbs in value would not be possible.

The Internet is undertaken by a great many investor, with their setting up and such engagement being a significant means of communication within the Saudi market, swiftly gaining widespread use. Furthermore, there is pervasive use of Twitter, Snapchat, WhatsApp and other social media. Clearly, the characteristics of such platforms mean that there is often rapid false information and rumors. It is possible that over 100,000 investor will hear a certain report or news within minutes, with incorrect information being disseminated widely, willingly or otherwise, via SMS and other communication means, having perhaps begun on social media platforms that are usually incredibly busy while trade is occurring.⁷⁰¹

There is a regulatory gap in Saudi market that is helping the spread of manipulation schemes that are based on rumors. In Saudi there is no direct prohibition from spreading false information; unless an untrue statement of material fact instead, issuers are obligated to respond to any ongoing rumors that are affecting the price of the issuer. This requirement is perfect in theory but it obliges very stringent surveillance and enforcement capabilities in practice. It is difficult to supervise and regulate these Internet channels, in fact that the Saudi market itself is actually grounded on such information. As mentioned, shortcomings exist in the current regulatory framework governing this area, although chapter three has provided an in-depth explanation of the existing structure of legislation.

In spite of this regulatory gap, Mature market typically possess proper information intermediaries and gatekeepers, which means that the Saudi market's framework is lacking rigour. Therefore, simply implementing stronger legislation is unlikely to tackle the problems,

⁷⁰⁰ Nancy Toross, 'Double-Click on This: Keeping Pace with On-Line Market Manipulation' (1998) 32 Loy LAL Rev 1399.

⁷⁰¹ Robert A Prentice, 'The Future of Corporate Disclosure: The Internet, Securities Fraud, and Rule 10b-5' (1998) 47 Emory Lj 1.

despite it certainly being required. Furthermore, market manipulation plans and the dissemination of false news' impact would be mitigated, in terms of the sharp increase and decrease in prices from a flurry of market activity, if companies' share prices were steadied and preserved to a degree by professional market makers. Manipulation schemes particularly target amateur, inexperienced and poorly informed investor, who seem to comprise the majority and who should be provided with proper instruction, which is a significant obstacle for regulators. The enhancement of market organizations and systems must incorporate such education as part of improvement plans, as it is a difficult area to change.

5.6 Regulations (Prohibiting) Market Manipulation

In this section, it will focus on the first illegal market activity described above, namely market manipulation. This crime is discussed and analysed based on the parameters outlined in the law and outside sources related to market manipulation in the Saudi regime and in the British regulations. Then it will cite some examples of market manipulation. Finally, it will analyse some of the decisions and provisions that have been published by the Saudi Capital Market Authority.

Chapter VIII, article 49 of the Saudi capital market law⁷⁰² defines the crime of market manipulation and reflects upon certain cases as follows:

(a) Any person shall be considered in violation of this Law if he intentionally does any act or engages in any action which creates a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression or thereby inducing third parties to buy, sell or subscribe for such Security or to refrain from doing so or to induce them to exercise, or refrain from exercising, any rights conferred by such Security.⁷⁰³

(b) The Authority shall set out rules determining the acts and practices which shall constitute violations of paragraph (a) of this Article. These rules shall specify the acts and practices excluded from the application of the provisions of paragraph (a) of this Article. The powers of the Authority provided for in this paragraph shall include the power to set forth the rules, define the circumstances and procedures aiming at stabilizing the prices of Securities offered to the

⁷⁰² Article 49 of the Saudi capital market law.

⁷⁰³ Chapter VIII, article 49 of the Saudi capital Market Law (2003)

public, and the manner in which and the period during which these actions must be taken.

(c) The following acts and practices shall be among those which shall be considered types of manipulation that are prohibited by paragraph (a) of this Article:

1) To perform any act or practice aiming at creating a false or misleading impression of an existing active trading in a Security as may be contrary to the reality. These acts and practices shall include, but not be limited to the following:

(a) Undertaking transactions in Securities which do not involve a true transfer of ownership thereof.

(b) Entering an order or order for the purchase a particular Security with prior knowledge that an order or orders of substantially the same size, price and timing for the sale of the same Security has been or will be entered by a different party or parties.

(c) Entering an order or orders for the sale of a particular Security with prior knowledge that an order or orders of substantially the same size, price and timing for the purchase of the same Security has been or will be entered by the same party or different parties.

2) To affect, alone or with others, the price of a particular Security or Securities traded on the Exchange through executing a series of transactions in such Security or Securities creating actual or apparent active trading or causing an increase or decrease in the prices of such Securities, for the purpose of inducing third parties to buy or sell such Securities as the case may be.

3) To affect, alone or with others through any series of transactions such as buying or selling or buying and selling a Security traded on the Exchange for the purpose of pegging or stabilizing the price of such Security in violation of the rules set forth by the Authority for the safety of the market and the protection of investor.⁷⁰⁴

By studying and analysing the above articles from a legal point of view, it becomes clear that the regulator classifies as market manipulators both those who act unlawfully and those who do not act lawfully (i.e., both action and inaction can result in the offence of market manipulation). Therefore, the designation of manipulation has three forms: first, participating in agreement with an offender/offenders to do one of the prohibited acts; second, participating in inciting, such as broadcasting rumours or recommendations that influence the price of securities; and third, participating in what is known as rounding between investment funds or making a deal based on incorrect information that was promoted by offenders to influence the

⁷⁰⁴ *ibid.*

stock. The aim of profiting illegally, either personally or on behalf of others, can be achieved through a number of means, including the promotion of speculators with influence and making a deal according to information from the same sources, from unofficial sources (e.g., chat rooms), from newspapers or from information published on the Internet.⁷⁰⁵

However, questions have been raised about, Will Intent be an Obstacle for Enforcing the Law? Regulatory bodies continue to question and disagree over whether an offender's intent should be considered. Certain regulatory frameworks are not concerned with manipulative intent, whereas different frameworks are. It is common that the manner of intent is distinguished within the jurisdictions that are concerned with it; scienter is the term applied in securities law to wrongful intent, with the term mens rea also having associated meaning. For example, fraudulent intention may have to have been instigated or engaged in by the accused under certain jurisdictions, others prosecutor require evidence of manipulative intent, while others may need evidence of actual intent to initiate or participate in artificial transactions. Thus whether there was wilful deception or fraud or not, it may only be necessary by prosecutor to show that prices were artificially altered through the activities of the accused.⁷⁰⁶

The accused individual's intention can be ascertained based on whether their actions possessed any lawful drive or sound justification in business practice, which must be challenged by the prosecutors under the regulatory framework. The burden of proof and conception of intent under Saudi Arabian law is affected by the country making a civil and criminal offence of manipulation. A decrease in the burden of proof would result, making it simpler to apply the law to transgressors, if a set of objective criteria were set for proving manipulative intent.

There are two main types of market manipulation: abusive behaviour⁷⁰⁷ and false information. Three pillars must be present to cause an action to be classified as either of the two types of market manipulation; in the absence of any of the two, the action is no longer designated as criminal behaviour. Following are the three pillars:

⁷⁰⁵ *ibid.*

⁷⁰⁶ Hereinafter "IOSCO Market Manipulation Report, 'Investigating and Prosecuting Market Manipulation, Technical Committee of the International Organization of Securities Commission' (2000).

⁷⁰⁷ Gerard Caprio, Handbook of Safeguarding Global Financial Stability: Political, Social, Cultural, and Economic Theories and Models (Academic Press 2012) P385.

Legal qualifications: There is no crime and no punishment except by law, as outlined in Article 59, which describes fraud and market manipulation.⁷⁰⁸

Material elements: This is stipulated in paragraphs (a) and (c) of Article 49. Although paragraph (c) has been applied to certain cases, paragraph (a) is the preferred section for application to the crime of market manipulation, in general. Paragraph (a) states the following:⁷⁰⁹

Any person shall be considered in violation of this Law if he intentionally does any act or engages in any action which creates a false or misleading impression as to the market, the prices or the value of any Security for the purpose of creating that impression or thereby inducing third parties to buy, sell or subscribe for such security or to refrain from doing so or to induce them to exercise, or refrain from exercising, any rights conferred by such Security.

It can be argued that there are a number of cases taken from British and U.S. law that are in line with the spirit of this law and could therefore be applied. It will discuss each individual case in detail in the following section.

As stipulated in paragraph (c), some of the behaviours that are fraudulent and misleading include three types of manipulation (1, 2, 3), which each contain three branches (a, b, c). To illustrate these, it has cited certain cases that occurred outside the Saudi system but which could be applied to the rules outlined in (c). These examples can make it easier to understand how the regulations should be applied.⁷¹⁰

Paragraph (c) also stipulates the following: ‘Acts and practices shall be among those which shall be considered types of manipulation that are prohibited by paragraph (a) of this Article: 1) To perform any act or practice aiming at creating a false or misleading impression of an existing active trading in a Security as may be contrary to the reality’. Nevertheless, there are several forms and manipulation methods. Still, all of these methods are designed to achieve one purpose, which is to change the price of the securities for the benefit of a person by fraud and misleading others.⁷¹¹

⁷⁰⁸ Article 59 of Saudi Capital market law.

⁷⁰⁹ *ibid.*

⁷¹⁰ *ibid.*

⁷¹¹ Article 59 of the capital market law.

The Saudi legislator has stipulated both criminal and civil penalties for market manipulation. The civil penalties aim to compensate people affected by the criminal offence when it is established in front of the Committee of Securities Disputes. Meanwhile, the criminal penalties stipulate fines and imprisonment. The term of imprisonment cannot exceed five years, while the fines imposed by the Commission or the Council, as stated in paragraph (b) of Article 59 of the capital market law, comprise a minimum of 10,000 riyals and a maximum of 100,000 riyals for each violation committed by the defendant.⁷¹²

In the UK, market manipulation is regulated under Sections 118 and 397 the FSMA 2000. Moreover, the UK regulations considers market manipulation as a criminal offence that incurs both civil and criminal punishments. Furthermore, Section 397 elucidates two offences.⁷¹³ The first involves creating a misleading statement that may involve one of three behaviours, as definite in Section 397 (1), and applies to a person who:

“(a) makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular;

(b) dishonestly conceals any material facts whether in connection with a statement, promise or forecast made by him or otherwise; or

(c) recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material particular.”⁷¹⁴

In addition, the second criminal offence as stated in Section 397 (3) " Any person who does any act or engages in any course of conduct which creates a false or misleading impression as to the market in or the price or value of any relevant investments is guilty of an offence if he does so for the purpose of creating that impression and of thereby inducing another person to acquire, dispose of, subscribe for or underwrite those investments or to refrain from doing so or to exercise, or refrain from exercising, any rights conferred by those investments.”⁷¹⁵

With regard to these offences the UK regulator the defences for these two sanctions which is regulated under the firstly Section 397 (4)

(4) In proceedings for an offence under subsection (2) brought against a person to whom subsection (1) applies as a result of paragraph (a) of that subsection, it is a defence for him to

⁷¹² Paragraph (b) of Article 59 of the capital market law.

⁷¹³ Section 397 of FSMA 2000.

⁷¹⁴ Section 397 (1) of Financial Services and Market Act 2000.

⁷¹⁵ *ibid.*

show that the statement, promise or forecast was made in conformity with (a) price stabilising rules; (b) control of information rules; or (c) the relevant provisions of Commission regulations (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments.⁷¹⁶

Secondly: (5) In proceedings brought against any person for an offence under subsection (3) it is a defence for him to show (a) that he reasonably believed that his act or conduct would not create an impression that was false or misleading as to the matters mentioned in that subsection; (b) that he acted or engaged in the conduct (i) for the purpose of stabilising the price of investments; and (ii) in conformity with price stabilising rules; F2. . . (c) that he acted or engaged in the conduct in conformity with control of information rules[F3; or (a) that he acted or engaged in the conduct in conformity with the relevant provisions of Commission regulations (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments.⁷¹⁷

5.7 Forms of Market Manipulation under Saudi Stock Market Regulations

As it has been mentioned above, it has been difficult to find a clear and comprehensive definition for the term market manipulation in both Saudi and UK regulations (which examined in section 1 with the common forms of manipulation which discussed in section 2) it is useful to test the forms of market manipulation that have been determined by both regulations. Therefore, this section explains the market manipulation forms under Saudi capital Market Law (2003) in comparison with the forms of manipulation under the FSMA 2000.

5.7.1 Manipulation Based on Misleading Information

Information-based manipulation involves releasing false information that will mislead others in the market. Furthermore, it is considered one of the most significant forms of manipulation

⁷¹⁶ *ibid.*

⁷¹⁷ *ibid.*

and may represent the first phase of other forms of manipulation.⁷¹⁸ In this regard, this form is regulated under Chapter VIII, article 49 of the Saudi Arabian stock market law,⁷¹⁹ which prohibits any act or practice aiming to create a false or misleading impression from a source, broker, trader or advisor linked to securities. For example, participating in what is known as rounding between investment funds or making a deal based on incorrect information are measures used by offenders to influence stock. According to this situation, the manipulation takes place because the misleading information related to a specific security leads to a higher price than the actual price.⁷²⁰

However, information-based manipulation has been banned under Section 118 (7) of the FSMA 2000. This form of manipulation is broadcasting of information that would give a incorrect impression by a person who ‘knew or could reasonably be expected to have known that the information was false’⁷²¹

Moreover, Section 118 (7) states that ‘... 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 qualifying investment by a person who knew or could reasonably be expected to have known that the information was false or misleading’.

According to the KSA and UK regulators, any kind of information that could affect the share price or mislead others is banned. However, the FSA has defined dissemination in MAR 1.8 as : “

- 1- Knowingly or recklessly spreading false or misleading information about a qualifying investment through the media, in particular through information channels.
- 2- Undertaking a course of conduct in order to give a false or misleading impression about a qualifying investment.”⁷²² In this regard, an individual who spreads the information that has

⁷¹⁸ Avgouleas and others (n 473). P104.

⁷¹⁹ Article 49 of the Saudi capital Market Law (2003) .

⁷²⁰ Chapter VIII, article 49 of Capital Market Law.

⁷²¹ Andrew Henderson, ‘Misuse of information, Chinese walls and changes to the FSA’s Code of Market Conduct’, (2005) 20 Journal of International Banking Law and Regulations, p. 1-6.

⁷²² Market Abuse Regulations: MAR 1.8.

been requested by the CAM and FSA, the availability of criminal intent and the availability of premeditation. Non-intentional actions do not fall within the criminal operations⁷²³.

5.7.2 Manipulation Based on Artificial Transactions

The second category is called manipulation based on artificial transactions; such manipulation regulated under article II, paragraph b/1 of the Saudi market conduct regulations; this category includes wash sales, matched orders and pools. Moreover, Article I (2)(b) of the EU Market Abuse Directive⁷²⁴ and FSMA Section 118 give clear descriptions of such market activities.

To give a brief example, the Financial Services Authority has fined two former directors of the Cattles plc and its subsidiary Welcome Financial Services Limited a total of £600,000 for disseminating misleading information to other investor according to the credit quality of Welcome's loan book and performing without integrity in discharging their responsibilities. In addition, the FSA banned both them from performing any functions related to any FSA regulated activities. Furthermore, John Black was banned by the FSA and fined £100,000; however, Blake has referred his case to the Upper Tribunal.⁷²⁵ As can be seen, although the Saudi and UK legislatures have both used the term 'artificial', this is not defined in the regulations. For both countries, the regulators described this term by giving examples, such as matched orders or pools.

However, the FSMA 2000 under Section 118 (5), which states, '... the behaviour consists of effecting transactions or orders to trade... which: c. (b) secure the price of one or more such

⁷²³ Furthermore, how the FSA is expanding the definition of the type of information that affects security prices is evident from the example of when the FSA fined Christopher Gower £ 50,000.⁸¹ Because he disclosed misleading and incorrect information regarding Enterprise Inns plc (ETI) to client in his research analyst position, it was translated as information-based manipulation. In this case, spreading false analytical recommendations was considered manipulation because it would ultimately increase the demand for and the price of the security.

⁷²⁴ Article I (2)(b) of the EU Market Abuse Directive.

⁷²⁵ Cattles Plc V Welcome Financial Services Ltd. [2009]

investments at an abnormal or artificial level’.⁷²⁶ As discussed in the previous section, the UK regulator differentiates security prices that are at an abnormal or artificial level, which means that manipulation has occurred, since the manipulator has created an incorrect price for these securities. Therefore, the investor stabilises the price of the share according to his/her plan or interest by controlling it. In contrast, there is no similar approach in the Saudi regulations.⁷²⁷

6.7.3 Manipulation Based on Fictitious Devices

Section 118 (6) of the FSMA 2000 provides a clear explanation of manipulation based on fictitious devices, as follows: ‘.....The behaviour consists of effecting transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance’.⁷²⁸ The FSA gave examples of what it considers manipulating devices in MAR 1.7, as follows:⁷²⁹

Firstly; “A transaction or series of transactions that are designed to conceal the ownership of a qualifying investment, so that disclosure requirements are circumvented by the holding of the qualifying investment in the name of a colluding party, such that disclosures are misleading in respect of the true underlying holding. These transactions are often structured so that market risk remains with the seller. This does not include nominee holdings.”

Secondly: ‘Pump and dump’: Here, a manipulator has a huge amount of shares of the company – often a company with a small amount of capital – and attracts the attention of investor to the stock. Moreover, the manipulator supports rumours and spreads false and misleading information about the security to achieve greater profits. When the market begins to interact with these data and news, investor start buying the stock, leading to inflation of the stock price. Then, the manipulator starts to sell the stock, generating large profits. Once the misleading data and rumours explode, the bloated share price falls to low levels.⁷³⁰

⁷²⁶ Section 118 (5) of FSMA 2000.

⁷²⁷ Slaughter and May (n 580).

⁷²⁸ Section 118 (5) of FSMA 2000.

⁷²⁹ MAR 1.7.

⁷³⁰ Lawrence R Klein and others, *Regulating Competition in Stock market: Antitrust Measures to Promote Fairness and Transparency through Investor Protection and Crisis Prevention* (John Wiley & Sons 2012) vol P812.

Thirdly: ‘Trash and cash’: This involves holding a short position in a qualifying investment and then disseminating rumours about it to decrease its price.⁷³¹

An example of this form is the case of Barnett Michael. “The Financial Services Authority (FSA) has obtained a court order preventing Barnett Michael Alexander, a self employed trader, from committing market abuse (by entering multiple orders to buy and sell shares) and ordering him to pay a £700,000 fine and £322,818 in restitution to firms which experienced a loss as a result of his actions”⁷³²

“Article III of the regulations of the conduct of the Saudi market of paragraph (b) has stated:

5) Entering an order or orders for the purchase or sale of a security in order to:

Establish a predetermined sale price, ask price or bid price;

Effect a high or low closing sale price, ask price or bid price;

Maintain the sale price, ask price or bid price within a predetermined range; or

Entering an order or a series of orders for a security that are not intended to be executed.”⁷³³

This includes four forms that can be carried out by the violator alone, more than one manipulator in agreement with each other, or several manipulators under the umbrella of a master manipulator. They can spread rumours, or disseminating them the Internet or recycle them through the exchange of information among the mediators.

Section 118 (8)⁷³⁴ also put forward a method to examine whether a specific behaviour is manipulation. Misleading conduct is considered market manipulation ‘when a regular person

⁷³¹ *ibid.*

⁷³² ‘FSA Bans and Fines Self Employed Trader £700,000 for Market Abuse’ (2011) <<http://www.fsa.gov.uk/pages/Library/Communication/PR/2011/053.shtml>> accessed 9 April 2017.

⁷³³ Article III of the Regulations of the conduct of the Saudi market.

⁷³⁴ Section 118 (8) states:

[T]he behaviour...

(a) is likely to give a regular user of the market a false or misleading impression as to the supply of, demand for a 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 a behaviour that would distort, or would be likely to distort, the market in such investments, 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 to observe the standard of behaviour reasonably expected of a person in his position in relation to the market’.

gives a false impression through manipulation of the supply of, demand for or price of a specific share'. However, the Saudi method has no measure to examine whether the conduct is manipulation. Thus, this has to be determined the collection of evidence and clues, proved by the Capital Market Authority or by their seducer to demand a fine (public right) and compensation (private right). It is necessary to prove damages and a causal relationship to be compensated.

5.8 Evaluating the Forms of Market Manipulation and their Shortcomings

There is no doubt that the steps taken by the Saudi legislature to regulate market manipulation were necessary to establish greater protection for investor in the market. Therefore, this approach to regulating market manipulation can be examined in two ways. First, it is necessary to consider the extent to which the regulations of market manipulation is successful and whether it encompasses all of the manipulative practices identified. Second, it is necessary to consider whether Article 49 in the Saudi capital Market Law (2003) and Articles II and III of conducts in the Saudi market law have covered the most common forms of manipulation practices, as reviewed in the previous section, as well as whether they cover the common manipulation behind the Saudi stock market collapse of 2006.

Based on what has been a discussion in the previous sections, it show that there is a very great similarity in the regulations of manipulation between the Saudi and the British regime, through the study of the Saudi regime and analytical legally and in accordance with the law of the Saudi capital market, in article ninth fortieth and Article II and the third of conducts of the Saudi market law , as can be realized that the regulator has regulated the market manipulation, and also stated several forms of manipulation and Saudi legislator did not differentiate between the manipulation in the market and who is involved in the manipulation.

On this basis, it will be discuss behaviours that did not refer to Saudi a legislator, who could be considered to know the behaviour of manipulators. Because of their familiarity with governmental systems such as British law and financial institutions such as the Financial Services Authority and the London Stock Exchange, such legislators could be faced with full

legal action when manipulators are discovered.⁷³⁵

One manifestation of a crime such as this occurs when company executives take so-called directors bonuses. When the fiscal year ends or the date of their reward is reached, they determine the value of the reward based on the share price performance. Then, the director, member or other insider will deal in the security at the closing of the market and then sell them in the days that follow. Directors bonuses, along with manager manipulation of the market, are among the types of market manipulation that are based on insider information.⁷³⁶

Another form of manipulation includes wash trades and circular trades. This form of market manipulation can be found in the Saudi regime, and it can take the form of either personal or collective manipulation. Although they do not necessitate any real change or transfer of ownership of securities, circular trades can occur between two or more people who buy or sell orders with the prior knowledge that there are or will soon be similar orders for the same securities. In some cases, the manipulators conduct a series of operations that trigger actual orders (i.e., the real transfer of ownership of securities) or virtual active orders. Alternatively, they might create a security that has either a high or low price in order to attract others to the security or to maintain the stability of the price of the security leading up to the time when the manipulators plan to take advantage of it. The unlawfulness of this action is stipulated in the other paragraphs of Article 49 of the Saudi financial market system.⁷³⁷

There is another form of manipulation that occurs when an offeree company wants to take over the other company (the offeror or company). This manipulation is called *takeover fraud* and seeks to make the offer to succeed or fail by convince investor of the offeree company; alternatively, in the case of reverse acquisition, it seeks to make the offeror or target company accept or reject the offer. However, takeover manipulation fails in several ways, for example, when the offeree company or its financial advisor bets on the deal for the top price and percentage on what is being purchased (the target of the proportion of the stock), this makes

⁷³⁵ Caprio (n 703). P385.

⁷³⁶ Jensen and Meckling (n 343).

⁷³⁷ Charles J Cicchetti and others, *The California Electricity Crisis: What, Why, and What's Next* (Springer Science & Business Media 2004) P135.

existing investor of the offeree company less willing to accept the offer.⁷³⁸

In contrast, when the offeree company or its financial advisor reduces the financial presentation or the acquisition ratio, this makes the available documents seem less attractive. Moreover, if the offeror or target company or its financial advisor raises the value of the offer and the acquisition ratio of the offeree company, the deal will end in failure. Sometimes, fraud and manipulation is used to make the offer succeed, such as when the offeror or target company or its financial advisor bets a higher price for the shares or overvalues the company's shares to complete the transaction, and to make a more attractive offer, provides documents that will meet the approval of the investor of the offeree company, although they do not faithfully represent the value of the company.⁷³⁹

Another option is making the offeree company's investor more receptive to accepting the offer. When the officials of the offeror or target company and its financial advisor knows that the price that is offered for the acquisition of the offeree company is higher than the real price, the price is lowered slightly to cement the deal by making the investor of the offeree company more receptive to the offer. This also causes the offer to succeed. The Bottom line for the offeree company is that when the offeror or target company and the financial advisers carry out these acts, this kind of manipulation will take place.⁷⁴⁰

According to the Saudi system, a joint stock company must carry out a portfolio evaluation, they have to do it four times a year (semi-quarterly) when they are dealing and trading in active investment of portfolios of stocks that are difficult to liquidate (illiquid stocks). At the end of the quarter (i.e. in the last days) before the valuation date, this will increase and performance of the general appearance of the investment portfolio development. This must be done several times if necessary, for example, when the operating profit of the company decreases, and this has led to its success in its investments and operating profit. In this case, manipulation of the market has occurred, because the company's acts delude and mislead investor or other traders, making them think that the financial situation is better than it actually is.⁷⁴¹

⁷³⁸ Mark Bagnoli and Barton L Lipman, 'Stock Price Manipulation through Takeover Bids' [1996] *The RAND Journal of Economics* P124.

⁷³⁹ Jennifer Payne, *Takeovers in English and German Law* (Bloomsbury Publishing 2002) P71.

⁷⁴⁰ *ibid.*

⁷⁴¹ Capital Market law, Listing Rules.

Moreover, it will next look at cases of manipulation in the Saudi stock market. Specifically, it will examine private accounting fraud crimes in which board members and executive directors, in conjunction with companies' internal financial accountants, inflate financial statements so that they look attractive and take advantage of this to raise the value of company shares. This situation is known as creative accounting,⁷⁴² and its primary goal is to inflate assets in such a way that it is difficult to detect the inflation through internal audits.⁷⁴³ A related case has been viewed in great detail in Chapter three namely; Mobily Company.

Alternatively, shares can be reduced to give managers a bonus (i.e., a stock option). This means that when the management of a company wants to give one of the directors a rate or amount of equity, the director can falsify the dates and manipulate it, giving the director a larger proportion without any third parties knowing about it. The manipulated records appear in previous financial statements as a loss, which affects the existing shareholders.⁷⁴⁴

The term *stock option*⁷⁴⁵ indicates the right—but not the obligation—to buy or sell a stock in the future at a specified price and on a granted date. The right to buy a stock is called a call option, while its reverse, the right to sell a stock, is called a put option. The stocks are then returned to the ownership through the backdating of security-based documents—a form of security fraud—on the day the stock was trading at its lowest price. This puts the company in a better financial position based on its accounting reports, which attracts new employees and investor who did not read the previous financial statements. This manipulation can be detected by identifying the history of the stock price and how it was calculated. The U.S. Securities and Exchange Commission requires the disclosure of stock options when submitting financial reports.⁷⁴⁶ However, U.S. regulators began to fiercely resist such manipulations in 2002, after the collapse of one of the largest U.S. companies in the field of energy, Enron⁷⁴⁷, as well as the company WorldCom⁷⁴⁸ (in conjunction with the accounting office of Arthur Anderson). This

⁷⁴² Michael J Jones, *Creative Accounting, Fraud and International Accounting Scandals* (John Wiley & Sons 2011) PP3-8.

⁷⁴³ Carol A Cantrell, *Stock Options: Estate, Tax, and Financial Planning* (CCH 2008) PP1-4.

⁷⁴⁴ *ibid.*

⁷⁴⁵ Cantrell (n 739).

⁷⁴⁶ Peskir, G & Samee, F. (2008). The British Call Option. *Quant. Finance*. 13 (1), PP1-10.

⁷⁴⁷ Mark Jickling, 'The Enron Collapse: An Overview of Financial Issues' (Congressional Research Service, Library of Congress 2002).

⁷⁴⁸ Fotios Harmantzis, 'Inside the Telecom Crash: Bankruptcies, Fallacies and Scandals-a Closer Look

resistance took the form of the Sarbanes–Oxley Act, which sought to control companies’ accounting practices.

This law prompted both U.S. and foreign companies to trade shares in the U.S. stock market, as they were now required to submit annual reports to the U.S. Securities and Exchange Commission regarding their internal regulatory accounting procedures, the system of civil and criminal sanctions set in place in case of non-conformance to these regulations, a certificate indicating the completion of an internal audit and a statement of the increase of financial disclosure in the company.⁷⁴⁹ There is one aspect of this system that is difficult to apply, costing companies a lot when accountants and brokers review the financial statements. This is section 404, which ensures that an external auditor has checked whether the company has tightened its internal control over the accounting systems. In other words, the company is required to publish its financial report, concentrating on the internal audit structure and procedures for financial reporting. It should be referenced this point for two reasons: 1) there is a lack of qualified certified accountants in the Saudi Regime, and 2) accountants receive small financial return—never exceeding the rate of 1 to 10,000—leading to neglect on the part of professional accountants, which increases the level of manipulation that occurs in the industry. This, in turn, shakes the confidence of investor, devalues companies’ shares and, ultimately, often leads to bankruptcy.

The British market operates on a different principle in the application of the law upon companies. This regulatory approach is called ‘Comply or explain’. Although this advanced principle requires a lot from companies, its application to global accounting standards, and especially those of Saudi Arabia, will foster a better environment and allow Saudi Arabia to catch up to other market more quickly.⁷⁵⁰

5.9 Can Enforcement be Effective with the Existing Regulatory Gap?

It is imperative to consider enforcement prior to determining whether or not the existing regulatory framework has provided investor protection in the Saudi stock market. It is a

at the Worldcom Case’ [2004].

⁷⁴⁹ Securities and others (n 385).

⁷⁵⁰ bid.

relatively simple matter to import and utilise regulations from elsewhere, such as those already in use in developed markets. However, ensuring that the laws can be effectively implemented is a much more challenging proposition because it requires regulators, the public, the judiciary, gatekeepers and lawyers to fully comprehend and apply them.

As yet, Saudi criminal law does not treat market manipulation as a serious criminal offence. This stance poses a barrier to those seeking to introduce general regulations into the Saudi market, particularly with respect to securities regulations. Thus, the investor themselves, Saudi regulators continue to place little emphasis on the importance of imposing criminal penalties on those manipulating the market thus ensuring a low level of enforcement.

This state of affairs indicates the level of apathy towards enforcement which currently pertains in Saudi. It can be surmised that regulators fail to uphold the law because they are aware that there are unlikely to be effective or deterrent sanctions imposed on any perpetrators, leaving those involved in manipulation free to continue with the practice. However, it is feasible that if the rule of law was strengthened, investor might come to realise that the law would be enforced notwithstanding the force of the sanctions actually imposed. The rule of law must apply equally to all those who seek to circumvent it. Therefore, it is imperative that both criminal and disciplinary sanctions are applied to those who manipulate market and that perpetrators understand that the risk of legal action is real.

5.10 Conclusion

In chapter six FSMA 2000, which was the UK's effort to more effectively control market manipulation, was compared to the contemporary efforts in Saudi stock market to legislate against market manipulation. The degree to which investor would be reassured and stock market expansion assisted through the regulations was also investigated.

Unpredictability within a market and undermining of the actual economy can occur due to the value of a stock being significantly different from its price, which is an effect of the stock market's fairness and justness being gravely compromised by market manipulation. The array of investor of a company are often those who will be affected initially, with effects of both a longer and immediate-term duration seen. Market liquidity can be affected because victims of manipulation and other investor may choose to leave the market, as their assurances about the

market have been challenged, which marks a long-term impact. Furthermore, for the actual economy to be effectively assisted by the market, some of the vital requirements of the stock market are integrity and fairness, as suggested by previous studies. Similarly, rampant manipulation in the stock market leads to the opposite, as the must compensate for stock market losses.

Due to the lack of empirical research that has been made into manipulation of market in Saudi Arabia, it is problematic to determine the degree to which manipulation is occurring. Nevertheless, because the stock market in Saudi may be significantly affected by market manipulation, the introduction of regulations to counter such activity is crucial, regardless of the lack of research undertaken.

During the 2006 crash in the Saudi stock market, many households had their investments wiped out. The market is not sufficiently transparent to reveal or prevent manipulation. However, Market manipulation is a poorly understood phenomenon, due in part to legal standards that categorize manipulative behaviour as either an act of outright fraud or the nebulous use of market power to produce an artificial price.

There is a major objective from market manipulation that is shared by all types and approaches, which is to deceive and defraud other individuals to the advantage of the manipulator, through altering securities values. Regardless, manipulation of a stock market should be clearly distinguished from speculative activity. Speculation includes positive aspects, which are legal, and negative aspects, which are illegal. In addition, the negative behaviour of manipulation is illegal. Market manipulation is an intentional misleading of investor and their decisions. Equity managers, government officers, industry experts, accountants, auditors and company executives may all engage in manipulation with the stock market. Sale washing, matched orders, pools, corners, churning, as well as pump and dump are the major forms of manipulation in the stock market.

Organising the work of brokers and financial consulting and encouraging institutional investment through various investment funds, and project financial analysts body are all positive mechanisms introduced by the Capital Market Authority. The advantages insider traders have and power they hold will likely be mitigated and a measure of equilibrium gained over the long-term, following the introduction of these strategic policies.

Whether successful enforcement can be achieved, given the current lack of legislation, is a crucial question. The degree to which investors are protected by the existing regulatory framework must be assessed, however the enforcement of any regulations is an essential prior question. Advanced markets have regulations that are already known to be sound, therefore they could easily be applied to the Saudi stock market. However, the understanding, introduction of and adherence to regulations in the legal field, by gatekeepers, citizens and watchdog bodies is potentially a considerable problem.

As yet, Saudi criminal law does not treat market manipulation as a serious criminal offence. Thus the implementation of securities legislation faces particular issues, while overall legislating of Saudi market is problematic due to such perceptions. Minimal application of the existing laws with respect to market manipulation, as well as the lack of imposing criminal penalties applied within the legal system thus ensuring a low level of enforcement.

Thus Saudi Arabia continues to take an indifferent attitude towards the enforcement of manipulation laws. Thus manipulation in the market and criminal activity is ongoing, with the legal system and regulatory likely believing that any sanctions will not be successful, nor pose a deterrent to such activity. However, it is feasible that if the rule of law was strengthened, investors might come to realise that the law would be enforced notwithstanding the force of the sanctions actually imposed. The rule of law must apply equally to all those who seek to circumvent it. Therefore, it is imperative that both criminal and disciplinary sanctions are applied to those who manipulate markets and that perpetrators understand that the risk of legal action is real.

Chapter 6: Fiduciary Obligations and Responsibility of Market Brokers

6.1 Introduction

Demonstrating sensitivity to the issue of meaningful investor protection, this chapter attempts to initiate a debate on the questions of the liability of broker acting as fiduciaries in the Saudi context, and to examine the legal aspects of the broker's role as the backbone of any securities market, in order to achieve the greatest degree of protection for investor and to inspire confidence in the stock market. The chapter concludes by examining how the law court determines and defines the fiduciary responsibilities of a broker's client.⁷⁵¹ The importance of this topic is determining the proper legal basis for the responsibility of the financial broker in the stock market, which represents a kind of protection for investor.

One of the main aims of this thesis is to conduct an evaluation of regulatory duties related to the protection of investor in the stock market. These duties are provided by regulations regarding the brokerage business in Saudi Arabia, and are evaluated here. Chapter six focuses primarily upon the elementary regulatory protection provided where a broker offers the services of executing orders and making recommendations, and by association the framework of protection that is provided in the context of the legal system of Saudi Arabia.

Broker is deemed significant since they work as intermediaries "who arrange on behalf of private investor the sale and purchase of shares"⁷⁵². In well-functioning stock market, it has long been considered that a broker or brokerage firm should conduct its client's transactions with due skill, care and diligence in accordance with sensible practice in the brokerage business. "It is for this reason, it is claimed, that stock market were established; to restrict entrance to market to brokers in order to ensure the conduct of its members and to limit

⁷⁵¹ In this chapter 'client' is a reference to an investor who is being served by a broker. The use of investor in lieu of investor is better at catching the legal relationship existing between the two i.e. investor vis-à-vis brokers.

⁷⁵² Securities and others(n 276).

fraudulent practices”.⁷⁵³ Therefore, it can be argued that the behaviour of broker can affect the health of stock market.

While, investment in the stock market is one of the most important types of investments for the time being.⁷⁵⁴ The importance of this type of investment to investors' desire to get the highest price of the security, and obtain the necessary legal guarantees to protect their securities, the risks that may cause their investments from fraud and manipulation of prices, also it perpetrated by some brokerage firms that take advantage of the lack of investors' experience in the field of securities to achieve their ends.

From here it tended to provide most of the legislation to protect the investor, through legislative means, to ensure that securities prestige and the confidence of investor in the market, and the completion of this protection provided by this legislation, Therefore, these provisions of legislation to regulate the work of the broker, who enjoys a privileged legal status, who is an agent for its client , and so has extensive powers, can it be exploited, abused or used to cause the collapse of the market and then the impact on the national economy.

In Saudi Arabia there is an increasing quantity of individual investor trading on the stock market who possess a limited knowledge of financial matters, such as financial analysis and risks of investment. Saudi regulators, however, are encouraging investor to seek assistance from experienced personnel, such as brokers, and thereby create a more established and official stock market, like that in the UK, for instance.

Recently, there has been substantial regulatory attention of broker with exploited conflicts of interest that invest their firms based on stock market imperfections and asymmetric information, which impairs stock market growth. Consequently, public confidence in stock market weakens while citizens and investor seek protection for their securities from unfair and

⁷⁵³ Sultan Alabdulkarim, ‘An Evaluation of Investor Protection in Secondary Securities Markets’ [2012] P118.

⁷⁵⁴ Olivier Blanchard and others, ‘The Stock Market, Profit and Investment’ (National Bureau of Economic Research 1990).

unsound practices and strive to achieve justice, efficiency and transparency in future securities transactions.⁷⁵⁵

The brokerage is an important component of the financial system. Its services are essential, particularly regarding large volumes of trade and the lack of knowledge and information. The brokerage reconciles the wishes of the parties to the deal, that is, between the asylum and the viewers of capital. Therefore, it represents both the owners of the fiscal surplus in investing their surpluses and the owners of the fiscal deficit in meeting their need for financing.⁷⁵⁶

The substance of the matter of illegal practice acts by stock broker function the current issue in Saudi Arabia, especially after the collapse of the Saudi stock market in 2006. As broker is dealing with massive amount of money which requires them to be precise and do not commit any errors in the implementation of client's orders that may entail enormous loss of the client invested fund, as broker play a very significant role in client's protection in stock market.⁷⁵⁷

“There are numerous accounts of emerging market today which show similar concerns: Khanna, in a case study of the Indian stock market, states that “Brokers were also often accused of collaborating with company owners to rig share-prices in pump-and-dump schemes”.⁷⁵⁸ Zhou and Mei argue that manipulation is rampant in many emerging market where regulations are weak and note that China's worst stock-market crime in 2002 was a scheme by seven people accused of using brokerage accounts to manipulate company share prices”.⁷⁵⁹

Within the financial sector, broker's client trust and act on their broker's advice; therefore, there is a great deal of responsibility on the part of the broker toward his/her client. There are various sources of the broker's advice; for example, arising from client's communications with

⁷⁵⁵ Donald C Langevoort, ‘Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics about Stockbrokers and Sophisticated Customers’ [1996] California Law Review 627.

⁷⁵⁶ Seha M Tinic and Richard R West, ‘The Securities Industry under Negotiated Brokerage Commissions: Changes in the Structure and Performance of New York Stock market Member Firms’ [1980] The Bell Journal of Economics P29.

⁷⁵⁷ Ahmed A Alzahrani and others, ‘Price Impact of Block Trades in the Saudi Stock Market’ (2013) 23 Journal of International Financial Markets, Institutions and Money P322.

⁷⁵⁸ Asim Ijaz Khwaja and Atif Mian, ‘Unchecked Intermediaries: Price Manipulation in an Emerging Stock Market’ (2005) 78 Journal of Financial Economics P203.

⁷⁵⁹ *ibid.*

the broker, or from the broker's own research alone; however, it is a legal requirement for broker to divulge all information regarding their recommendations, both the opportunities and the risks. With such heavy responsibility, there is a fear of legal liability, and as such, recommendations must be well-researched and thoroughly considered. Finding the appropriate recommendation suited to each individual client is not always straightforward. Institutions in emerging securities markets, such as Saudi Arabia, have not received a sufficient amount of research, particularly in the legal aspects related to the functioning of these companies.

6.2 Are Brokers a Source of Market Manipulation?

Brokers are a main element of any stock market as they act as intermediaries between traders. Because brokers have access to extensive inside information and possess a better understanding of the market due to their experience and practice within the stock market.⁷⁶⁰

However, if we view a brokerage from the perspective of business services rather than as part of the market structure it appears to raise different legal matters. Previously, the only practice enabling profit to be made from offering brokerage services was charging commission for each transaction. However, it is now claimed that the business model adopted by most, but not all, financial institutions has transferred to charging fees based on the volume of assets under management.⁷⁶¹

Such a transformation in the business model has caused in two main developments in the practice. "Firstly, from an investor's perspective, the investor is better off increasing the volume of trading; since the more trade which is executed, the less costly the charges become. Secondly, broker has become more aggressive in marketing other services in order to generate additional income".⁷⁶² As a result, there is a risk that broker may encourage their client to change their investment plans or adopt a strategy, such as stock lending or margin financing, that would carry more advantage to the brokers, whilst at the same time exposing the client to additional risks.

⁷⁶⁰ *ibid.*

⁷⁶¹ Ingo Walter, 'Conflicts of Interest and Market Discipline among Financial Service Firms' (2004) 22 *European Management Journal* P361.

⁷⁶² Alabdulkarim (n 16).

Broker is considered the fundamental players in market manipulation schemes because all offenders are required to trade through brokers.⁷⁶³ Thus, in order to manipulate the process to succeed in the market, the broker must be complicit in perpetrating the fraud. Consequently, regulators aim to enforce limitations on brokers, forbidding them from engaging in such activities. The governance of stock market broker through the proper design and enforcement of laws and regulations, specifically in emerging markets, has recently received more importance. Therefore, there is an increasing belief that emerging markets, such as the Saudi stock market, require amendments to improve their legal and institutional environments.⁷⁶⁴

Therefore, the Saudi capital Market Law (2003) , prohibits intermediaries from practicing in a way that against investor benefits, such as falsifying transactions for the purpose raising (commissions). The law is designed to limit the ability of the broker to publish any misleading or inaccurate information which may affect the investor decisions. The non-application of this law will lead to undermining the confidence of investor in the market, as well as limiting the evolution and growth of the stock market, as well as undermining the investor protection.

Brokerage firms are playing more significant roles in the growing financial market and are essential in the modern state's economic regulations. These brokerage firms are entrusted to perform the process of trading in the stock market and to conduct all other tasks related to the securities industry, emerging as a prominent financing competitor to banks. In order for the stock market to carry out its functions, the broker must play a critical role in the trading process. Broker enable investor to trade and, thus, provide liquidity. They are also responsible for ensuring that the entire process operates free from stock market fraud. Securities market in any country require brokerage companies to create an economic and financial environment to promote development in accordance with the modern standards and conditions. Therefore, these companies strictly control the laws in order to claim the role required of them.⁷⁶⁵

⁷⁶³ Lawrence M Salinger, *Encyclopedia of White-Collar & Corporate Crime* (Sage 2005) vol 1.

⁷⁶⁴ Steven Mark Levy, *Regulations of Securities: SEC Answer Book* (Aspen Publishers Online 2011) PP22,31.

⁷⁶⁵ Langevoort (n 751).

6.3 Theoretical Perspective on Brokerage

6.3.1 Definition of Broker

The Saudi legislature has cited several definitions of *broker*: The first definition: "authorized person: a person who is authorized to carry on securities business by the Authority."⁷⁶⁶ This is a brief definition, and does not explain the nature of the authorized person, whether it is a natural person or legal entity. But the advantage of this definition is that it includes all aspects of the securities business (dealing and protect, consulting, and management).

The second definition: the second Thirty Article of the Saudi capital Market Law (2003) stipulates that "Broker means a joint stock company that carries on brokerage activities and the broker agent who is working at the brokerage company and carries out all or part the following activities: acts in a commercial capacity as an intermediary in the trading of Securities, other than persons working on the basis of a contractual arrangement as defined in paragraph (b) of this Article, including any person who commercially acts as a custodian for Securities; presents in a commercial capacity an offer to others for obtaining financial assets in the form of Securities by opening an account through which transactions in Securities may be effected; effects in a commercial capacity Securities transactions for its own account other than by way of issuing Securities, in order to create a market in Securities and make a profit out of the difference between offer prices for Securities and demand; acquires or places Securities in a commercial capacity for an issuer or a person who controls an issuer; acts as an intermediary in a commercial capacity - other than persons who act on the basis of a contractual arrangement as defined in paragraph (b) of this Article - including in arranging currency or Securities swaps".⁷⁶⁷

However, the UK legislature has defined the term "Authorised Person" as a person who is authorised under section 31 of FSMA⁷⁶⁸ which state that "(1)The following persons are authorised for the purposes of this Act (a)a person who has a Part IV permission to carry on one or more regulated activities; (b)an EEA firm qualifying for authorisation under Schedule 3; (c)a Treaty firm qualifying for authorisation under Schedule 4; (d)a person who is otherwise

⁷⁶⁶ Glossary of defined terms used in Saudi Authorized Person Regulations.

⁷⁶⁷ Article 32 of the Saudi Capital Market Law (2003).

⁷⁶⁸ Section 31 of FSMA.

authorised by a provision of, or made under, this Act. (2) In this Act “authorised person” means a person who is authorised for the purposes of this Act.”⁷⁶⁹ Also, there is another definition under term of “ Broker dealer” According to the rule of London exchange stock that “Broker dealer” “in relation to transactions in securities of any description, a member firm which is not a market maker, a gilt inter dealer broker, or a wholesale dealer broker in those securities” ⁷⁷⁰

Summarize the above, that the financial broker is a person legally representing a brokerage firm. It is not permissible for non-brokerage firms in the Saudi regime to do some or all aspects of the securities business, which is doing the work on behalf of the investor. Further, that the system has to clarify the conditions and obligations and rights of broker, which will be discussed in detail in the next sections. Moreover, Saudi market law distinguishes between a broker, a dealer and an investment advisor and all of them require to register as an authorized person.

6.3.2 Functions of Broker

Market broker deal with diverse investor, therefore, their functions in the stock market vary according to the investor with whom they are dealing. Their main functions are the negotiation of securities and advice and counselling.⁷⁷¹

6.3.2.1 Trading Securities

The negotiation of securities relates to the implementation of buy or sell orders, from which market broker obtain a commission. Therefore, the broker works to achieve the best possible price (within the framework of negotiation). ⁷⁷²The commands are associated with a specific duration. The negotiation of securities requires knowledge of the conditions of the financial market and adequate information about the securities under negotiation. It also requires a great deal of experience in the movement of stock prices in the market. For example, the broker must

⁷⁶⁹ Section 31 of Financial Services and Market Act.

⁷⁷⁰ The rule of London exchange stock book, definitions. P5.

⁷⁷¹ Michael E Don and Josephine Wang, ‘Stockbroker Liquidations Under the Securities Investor Protection Act and Their Impact on Securities Transfers’ (1990) 12 Cardozo L Rev 509.

⁷⁷² Norman S Poser and James A Fanto, Broker-Dealer Law and Regulations (Aspen Publishers Online 2007) P22.

be able to decide correctly whether the time is right or whether it is better to wait until the right moment in order to achieve the best sale or purchase price for the customer.⁷⁷³

6.3.2.2 Advice and Counselling

Broker can provide advice and counselling to client regarding investment decisions and the factors that may involve the sale and purchase of the values transmitted in operations. The remaining limits of counselling and advice provided to the client depend on the conditions agreed upon between the broker and the client.⁷⁷⁴ For example, the broker might be committed to play only the role of adviser and not have the right to decide or to exceed the supervision of the values transmitted.⁷⁷⁵

6.4 The Brokerage Contract

In the stock market, the brokerage contract defines the rights and obligations of the broker and the client. Brokerage contracts vary according to the distinctive characteristics of mediation in securities. They include consensual contracts, onerous contracts and executed contracts.

6.4.1 Exchange Contracts

In consensual contracts, which result from the mere agreement of the parties. It does not demand the performance of any formal or representative acts to fix the obligation, also, the parties of the contract are willing individuals to the conclusion of the contract. This freedom is not absolute but constrained by the restrictions imposed by law to protect the parties to the contract and the organisation of the work in the stock market. For example, one of the restrictions imposed by the law is that the brokerage contract is that the form prepared by the brokerage firm, which is consistent with capital market law and its executive regulations. The Saudi legislature has committed both sides to writing and concluding brokerage contracts in securities.⁷⁷⁶

⁷⁷³ Eleni Zaude Gabre-Madhin, *Market Institutions, Transaction Costs, and Social Capital in the Ethiopian Grain Market* (Intl Food Policy Res Inst 2001) vol 124.

⁷⁷⁴ Richard Teweles and Edward Bradley, *The Stock Market* (7th Edition, John Wiley & Sons 1998).

⁷⁷⁵ *ibid.*

⁷⁷⁶ Poser and Fanto (n 768).

It is worth mentioning that the brokerage contract in securities is not a submission contract because it does not contain arbitrary conditions on the part of the company. In the Saudi regime, Article (38 / b) of the regulations for authorized persons deals with the terms of the provision of services to customers. It states explicitly that the terms of the contract or agreement between the parties should adhere to the conventional formula. The Saudi legal system gives legislative guarantees to the client (investor) in dealing with brokerage firms in securities.⁷⁷⁷

6.4.2 Consensual Contracts

One advantage of brokerage contracts in securities is the consensual contract. This type of contract creates mutual obligations between the parties and obliges the brokerage company to sell and purchase securities for the account of the client. In exchange, the client pays the agreed commission. The broker is not paid a fee if the mediation does not lead to the conclusion of the contract. If there is no conclusion of the contract because of the broker's intransigence, the court may compensate the broker in a suit of effort. In onerous contracts, the brokerage firm has the legal right to deduct the commission from the customer's account without reference to the client.⁷⁷⁸

6.4.3 Executed Contracts

This type of contract concerns the content of the implementation, where the brokerage firm is committed to ensuring that the contract is fulfilled. Even if the client does not comply with the extradition of securities or the payment of securities that have been purchased, it falls on the brokerage firm's commitment to guarantee in all cases the implementation of its own money, as stated in the law. Thus, if the securities have perished, the brokerage firm bears the responsibility to provide other securities to perform the contract. In executed contracts, the commitment of the brokerage company is to ensure the implementation of the contract.⁷⁷⁹

⁷⁷⁷ Saleh Mutawa, *Securities and Applications Disputes in Saudi Arabia: Administrative - Criminal - Compensation* (King Fahd National Library 2015) P333.

⁷⁷⁸ Marcia Darvin Spada, *New York Real Estate for Brokers* (Cengage Learning 2008) P79.

⁷⁷⁹ Mutawa (n 245).

6.5 Legal Aspect for Broker in Securities

In securities trading, the brokerage process is a business, and the person who performs this work is considered, either natural person or legal entity, a dealer. The trader is natural person or legal entity who carries his or her name and account in a professional business. Regarding a commercial enterprise (i.e., a business brokerage), the Saudi Commercial Court system states explicitly in Article (2) (considered one of the business all that is conducted (c) with respect to bonds; all kinds of transfers or money exchange and brokerage).⁷⁸⁰

After the issuance of the Capital Market Law in 2003, the mediation in securities was not considered until after the terms were offered, the necessary license was obtained from the Capital Market Authority, and proof of professional experience in dealing in securities was provided. There is no dispute that commercial brokerage companies serve brokerage purposes, but it is important that the company is committed to the obligations imposed by the law. However, the logical question that arises concerns the quality of the mediation. Is it a commission brokerage or a normal brokerage? Is it a special type of brokerage? In order to answer these questions, jurists follow a number of directions about the quality of mediation in the financial market, which the following example illustrates:

A team of jurists mediated a securities broker who was a commission agent, based on the method of the direct broker of the coin.⁷⁸¹ This greatly resembled the work of the broker commission because the broker contracts in his own name on behalf of the investor. According to this view, the commission agent contracts in his own name and the account of the investor, but if the brokerage firm receives buying and selling orders from investor, it is not lawful for companies to do business in their own names under the Saudi legal system.⁷⁸²

This example does not include the Saudi Commercial Court Law issued by Royal Decree No. M / 2 and the date 1390, the Saudi Arabia Commercial Agencies Law issued by Royal Decree

⁷⁸⁰ Laws Regulations . The Commercial Court Law (2014). Available: <https://mci.gov.sa/en/LawsRegulations /Systems And RegulatFahdions/Documents/a22.pdf>. Last accessed 02th Aug 2015.

⁷⁸¹ OP Malhotra Gangal SK Gupta & Anubhuti, S. Chand's ISC Mathematics Class-XII (S Chand 2007) P33.

⁷⁸² Emmanuel Vidal, The History and Methods of the Paris Bourse (US Government Printing Office 1910) vol 573 P24.P

No. M / 11 or the date of H20 / 2/1382 private proxy commission compact, except for the definition of the agency commission in the Commercial Court of Law, where the provision in Article 18 states, “The commission agent is a person engaged in the commercial activities upon trust or on behalf of others. The transactions of such agents shall be conducted in their names or by stating the address of the company of their authorizer”.⁷⁸³

The commission agent, whether an individual or a company, can contract with third parties in his own name on the behalf of others. The broker in the securities brokerage does not sign his own name but carries out the orders issued to him by the investor, regardless of whether it is buying or selling. The regulations for the Law of the Saudi capital market with respect to licensed persons are stated in article (47), which stipulates the following:⁷⁸⁴

“Contract Notes (a) An authorised person who effects a sale or purchase of a security with or for a client must send the client a contract note forthwith. Authorised Persons regulations 47 (b) A contract note does not have to be sent where the authorised person is acting as manager and the client has confirmed that he will not require such contracts notes to be provided in writing. (c) Contract notes must provide the information required in Annex 5.5.”⁷⁸⁵

Article (47) stipulates that the broker’s work lies in the agency of the client, which is both in buying and selling, under the Agency's own conditions. The condition that concerns us is dealing on behalf of and for the account of the client. Because the deputy broker for the client acts in the name and account of the client, the law requires the broker to open an account for the benefit of the client (investor) without being involved in the trade paper of the client or dispose of his money without a certified power of attorney from the same client. Based on the above, the fundamental differences between a brokerage in securities and an agency commission is that there is no support that a stock broker is a commission agent.⁷⁸⁶

Although some opinions hold that the securities broker (commission agent), the nature of the place of contracting, and the securities of the movables starting. In response to this statement,

⁷⁸³ Royal Decree No. M / 2 and the date 1390, the Saudi Arabia Commercial Agencies Law issued by Royal Decree No. M / 11 or the date of H20 / 2/1382.

⁷⁸⁴ Article 47 of Authorized Persons Regulations .

⁷⁸⁵ *ibid.*

⁷⁸⁶ *ibid.*

the standard of discrimination in the work of broker securities is to oblige the law as requested by the profession, which stresses specialized precision in performance.⁷⁸⁷ The stock broker must adhere to the principles, rules, provisions and standards set forth for the exercise of private business trading securities to ensure the stability of the performance of the financial market on the near and distant levels, unlike the commission brokerage, which is a possible place of activity in trading any kind of portables. Therefore, it is not acceptable that a stock broker is a commission agent regardless of the number of views about this matter.⁷⁸⁸

In the preceding example, the last team of jurists reversed the view of the first team and differentiated between the broker contracting in his own name and the commission agent for the accounts of client. However, if his role was limited to the rapprochement between the parties to the transaction, he shall be an intermediary (broker) normal, and the evidence for this is the standard method of contracting.

This is a critical point. The commission agent cannot be regarded as a stock broker or an ordinary broker because the intermediary (broker) of securities is subject to the provisions of the Saudi capital Market Law (2003) and its implementing regulations. They require the broker to obtain licenses from the competent authorities in order to do business in the trading of securities. In addition, the broker in the financial market will be a guarantor in the field of mediation in securities under the law.

In another view, the mediation in securities is of a private nature. The researcher supports adapting mediation in securities as having an independent legal status subject to the system of the Saudi stock market. Under the law, the consequent commitment to the principles, rules and provisions and standards set forth in the law for the exercise of private business, a securities trading above this regulations and that intermediary (broker) is not a normal broker and is not an agent on commission. Brokerage firms usually hire natural persons as securities assistants (agents). Each securities brokerage firm must have one or more representatives who initiate brokerage business on behalf of the firm. The legal description of the assistant or agent varies depending on the relationship it has with the brokerage firm. If the relationship is an

⁷⁸⁷ Clifford Gomez, Financial Markets, Institutions, and Financial Services (PHI Learning Pvt Ltd 2008).

⁷⁸⁸ John L Teall, Financial Trading and Investing (Academic Press 2012)P9.

employment contract, then obligations arise from the employment contract. If the relationship is with the company's contract agency, it is an agent in accordance with an agreement with the brokerage firm.⁷⁸⁹

However, the Saudi law on the capital market selects the form of the relationship between the securities brokerage firm and its agent. It states explicitly that the agent works for the brokerage firm. Article (32 / A) of the same system states, "Broker means a joint stock company that carries on brokerage activities and the broker agent who is working at the brokerage company and carries out all or part the following activities...."⁷⁹⁰.

Based on the text, the agent is the company continued to mediation, and mediation is not practiced in his name or on his own account, but in the name and account of the company, which in turn earns the company the broker recipe, and the recipe merchant at the same time. The brokerage firm's obligations are imposed by law and apply to both broker that trade stocks, as well as dealers. In contrast, the agent does not acquire rights nor assume obligations other than the dictates of his employment contract.⁷⁹¹

Even the Saudi capital Market Law (2003) has identified acts by proxy, as cited in Article (32 / A) of the same Act, which states, "(a) Broker means a joint stock company that carries on brokerage activities and the broker agent who is working at the brokerage company and carries out all or part the following activities:."⁷⁹²

Acts in a commercial capacity as an intermediary in the trading of Securities, other than persons working on the basis of a contractual arrangement as defined in paragraph (b) of this Article, including any person who commercially acts as a custodian for Securities;⁷⁹³ Presents in a commercial capacity an offer to others for obtaining financial assets in the form of Securities by opening an account through which transactions in Securities may be effected; Effects in a commercial capacity Securities transactions for its own account other than by way of issuing Securities, in order to create a market in Securities and make a profit out of the difference

⁷⁸⁹ Gangal (n 777).

⁷⁹⁰ Article (32 / A) of Capital Market Law.

⁷⁹¹ *ibid.*

⁷⁹² *ibid.*

⁷⁹³ Article (32 / b) Saudi capital Market Law (2003)

between offer prices for Securities and demand; Acquires or places Securities in a commercial capacity for an issuer or a person who controls an issuer; Acts as an intermediary in a commercial capacity - other than persons who act on the basis of a contractual arrangement as defined in paragraph (b) of this Article - including in arranging currency or Securities swaps.⁷⁹⁴

6.6 How a Broker Provides Suitable Recommendations to his/her Client

It is known that in the original contract, that the relationship between the seller and the buyer directly, but that the legislature's failure to enforce this contract, this contract between the seller and the buyer only through brokers, and from here became broker are direct parties to the contract. On that arise between the seller and the broker and mutual commitments to each other.

6.6.1 Fiduciary Duty of a Broker Dealer in KAS and UK

When considering fiduciary duty, there are numerous meanings which can be addressed. At either equity or law, it is categorised as the uppermost standard of care. It is anticipated that a fiduciary or 'fid' should be tremendously devoted to the individual to whom they are indebted to or the 'principal' and they must not place their individual and personal needs and interests ahead of the duty.⁷⁹⁵ Additionally, if he/she does not have permission from the principal to do so, they must not generate proceeds from being a fiduciary. The term fiduciary was founded and originated from the Latin fides which means faith and fiduciary which means trust⁷⁹⁶.

To explain further, when the relationship with the client and fiduciary contains a high level of trust, assurance and dependence, these qualities are expected to be illustrated by the fiduciary's choice to represent them out of their freedom of choice or proficiency. It is imperative that the fiduciary ought to knowledgeably agree to accept the trust and assurance to apply his proficiency and discretion and act for the client. For instance, it is forbidden by the law that, when one individual conforms to acting for a client in a fiduciary relationship, to act in any means or

⁷⁹⁴ *ibid.*

⁷⁹⁵ Alan Calder, *Corporate Governance: A Practical Guide to the Legal Frameworks and International Codes of Practice* (Kogan Page Publishers 2008)P57.

⁷⁹⁶ Jane Lorenz and Lorenz Marguerite, *Ethics for Trustees: A Guide for All Who Serve as Trustee* (Author House 2011).

method opposing or conflicting to the principle interests and aims of the client, or, additionally, behaving in a manner for his own personal gain relating to the specific subject.⁷⁹⁷

The fiduciary must perform their full ability, compassion and attentiveness on behalf of their client as it is their fundamental right to receive the uppermost care from their fiduciary. Furthermore, when an individual has agreed to act as a fiduciary for a client, they are regarded in a specific light which requires them to act with excellent trustworthiness and is forbidden to attain any personal advantages which are only gained at the disadvantage of the client.⁷⁹⁸

The court discussed the following elements of fiduciary duty when referring to the Bristol and West Building Society v Mothew case: “The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary...”⁷⁹⁹ This specific case illustrates clearly how a principle has numerous fiduciary duties and responsibilities which they are expected to conduct gracefully for their client.⁸⁰⁰

Finally, essentially a fiduciary duty is an ethical, yet, legal relationship amid a client and a defendant. Overall, one party is responsible and has the legal duty to do their utmost to generate the desired result for the client, as long as there is a full admission and even if it is stated that there is a conflict of interest between the parties.⁸⁰¹

As mentioned above regarding the fiduciary duty obligation in general, the same concepts are applied for a broker as it is seen in Saudi market law. Consequently, as a broker has a duty to act with the highest standard of good faith and loyalty. Thus brokers' obligations must be met

p3.

⁷⁹⁷ D Theodore Rave, ‘Politicians as Fiduciaries’ [2013] P44.

⁷⁹⁸ Jeffrey N Gordon and Paul Davies, Principles of Financial Regulations (Oxford University Press 2016) P33.

⁷⁹⁹ Bristol & West Building Society v Mothew [1998] Ch 1 at 18 per tt" [Lord Millet](#)

⁸⁰⁰ Peter Birks and Arianna Pretto-Sakmann, Breach of Trust (Bloomsbury Publishing 2002) P71.

⁸⁰¹ John McGhee, The Role of Fiduciary Obligations in Commercial Disputes (2004)P16.

under the broker contract; this section will address the most prominent of these obligations. The broker should stick with seven obligations; it is on the whole: Because the Saudi regulator did not put a special chapter for the obligations of brokers. But it distributed between the lines of market laws and regulations. One criticism of the Authorized Persons regulations is that the Saudi regulator confused the terms of the broker and its obligations in Part II - Article (5) under the title (The Principles for Authorized Persons). This confirms the need to amend several materials and revise commitments in a separate chapter in the Saudi capital Market Law (2003)

⁸⁰²

A broker must adhere to seven obligations that clarify what a broker has to do in order not to breach his/her fiduciary duty obligation; these obligations are detailed as follows:

Taking Into Account The Interests Of Client : the necessity of the broker taking into account the interests of its client , including integrity, skilled care, diligence, and implementing transactions with fairness and justice, to avoid any inconsistency between the broker's interests and the interests of the client, and, if such a conflict of interests arises, to disclose it to the client.⁸⁰³

Informing client about Last securities prices: The broker must inform traders of the Last stock prices, because it is based on this information the investor make a decision,⁸⁰⁴ who make investment decisions based on a broker's statements and recommendation.

Protecting The Confidentiality of Investor Information: a broker has a fiduciary duty toward his client that must be committed to protecting investor information, and must not disclose this information, except in cases stipulated by law and regulations, as stipulated in Article 29 of the Authorized Persons regulations. An Authorized Person must keep information obtained from client confidential, except where: " 1) its disclosure is required by the Capital Market Law or its Implementing regulations or the applicable laws of the Kingdom; 2) the client has consented

⁸⁰² Article 40 of Authorized Person Implementing Regulations.

⁸⁰³ Article 7,8 of the Saudi Authorized Persons Regulations .

⁸⁰⁴ Article (5 / b / 8) of the Authorized Persons Regulations stipulate that communications with client be communicated "in a way which is clear, fair and not misleading"

to its disclosure; 3) its disclosure is reasonably necessary to perform a particular service for the client; or 4) the information is no longer confidential.⁸⁰⁵

Ensuring the availability of the price of the securities in the investor's account before the implementation of the deal: Before executing investors' orders, the Broker is obligated to ensure the availability of the price of the securities in the investor's account. All members must make sure before the pro-ordered the availability of trading documents, written in the correct format, and that the Broker shall be liable for any defect in the stock delivery or non-payment by the buyer of value.⁸⁰⁶

Executing trading orders according to the investor's instructions: The broker must implement the buying and selling of the security as instructed by the investor, in terms of type, time, and quantity. The brokerage firm, however, has the right to refuse certain client orders if there is legal justification to justify its refusal⁸⁰⁷. Legal justifications for refusal include manipulation in the market or insider trading.⁸⁰⁸

Informing The Investor Of The Outcome Of Implementation: When the broker receives orders from the investor in trading in certain securities, the investor should know the outcome of this order after implementation, and the broker is obligated to give notice to the investor periodically.⁸⁰⁹

Customizing in A Timely Manner: The broker, after the implementation of the order, should deposit in the investor's account the transaction amount in the case of a selling order, and the security if it was a buying order, to enable investor to take advantage of the results from the deal, as stipulated by the Capital Market Authority law.

However, according to the UK has similar concepts about fiduciary duty, the broker should comply with the FCA rules, which set out the fiduciary duty of a broker toward his client as

⁸⁰⁵ The Saudi Authorized Persons Regulations .

⁸⁰⁶ Salah AlTuwaijri, Broker Responsibility in the Stock Market in the Saudi System (Comparative Study) (Naif Arab University for Security Sciences 2014)P33.

⁸⁰⁷ Mutawa (n 245).

⁸⁰⁸ This is supported by the text of Article 11 of the Regulations of the Saudi Market Conduct.

⁸⁰⁹ AlTuwaijri (n 802).

followed⁸¹⁰: Firstly, integrity: the broker need to take caution on its business with integrity, and ensure the integrity of transactions carried out by to their client . secondly, skill, care and diligence: broker should conduct its transactions' client with due skill, care and diligence.

In *ICS Ltd v West Bromwich Building Society (No2)* [1999] *Lloyds Rep* PN 496 at 504 Evans-Lombe J said that in carrying out its tasks for a client, an IFA: "...owed to its client contractual duties to exercise the care and professional skills appropriate to an organization presenting itself as an expert independent financial adviser; to provide its client with independent advice in their best interests and not to allow its own interests to conflict with those of its client ..."⁸¹¹ thirdly, management and control: a broker must take reasonable care to organize and control its affairs responsibly and effectively, with adequate risk management systems. fourthly, financial prudence: a broker must preserve sufficient financial funds. fifthly, market conduct: a broker must observe proper standards of market conduct. sixthly, customers' interests: a broker must pay due regard to the interests of its client and treat them fairly. moreover, communications with client : a broker must take reasonable care to ensure the suitability of its advice and discretionary decisions for any client who is entitled to rely upon its judgment.

As broker's duties of care will often require them to take advice. In *Cowan v Scargill*, Mr Justice Megarry said: That duty [of care] includes the duty to seek advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice to act with the same degree of prudence. ... Although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition to being sincere he is acting as an ordinary prudent man would act"⁸¹² in the Court of Appeal's decision in *Pitt v Holt*, Lord Justice Lloyd said "where tax matters are relevant (as they often will be), it is likely to be the duty of the trustees, under their duty of skill and care, to take proper advice as to those matters."⁸¹³

⁸¹⁰ UK Law Commission and others, 'Fiduciary Duties of Investment Intermediaries. Law Com No 350' [2014] London: UK Law Commission.

⁸¹¹ *Investor Compensation Scheme Ltd. v West Bromwich Building Society* [1997] 1 All ER 1 UKHL 28.

⁸¹² *Cowan v Scargill* (1985) 10 All ER 857.

⁸¹³ *Pitt v Holt* (2011) 1 WLR 1171.

In addition, client' assets; a broker must arrange adequate protection for client ' assets when it is responsible for them. Finally,⁸¹⁴ relations with regulators a broker must deal with its regulators in an open and cooperative way and must disclose the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice.⁸¹⁵

6.6.2 Saudi capital Market Law (2003) and its Implementing Regulations Regarding Securities Fraud and Unsuitable Recommendations

While the Saudi capital Market Law (2003) method relating to fraud has similarities, the Saudi law has categorized financial fraud into two principle chief frauds. The first category is market manipulation and the second category is where all insider trading falls into, yet, they each have distinct articles.

Article 49 discusses the fraud of market manipulation briefly and mentions some defilements which disobey the law, however, there is no thorough state regarding the restrictions for the forms of frauds which have been addressed. It is a convenient method for adding additional defilements as it alters on a regular basis. The law has enabled and given the power to Capital Market Authority to produce updated regulations whenever it is necessary. From this exploration and investigation, this article forms the primary anti-fraud establishment in relation to securities fraud. Furthermore, the Saudi regulator (CMA) has the capability to identify the claim inappropriate endorsement claim that is provided by a client or broker.

Additionally, Market Conduct regulations is a further instigating law which has been established by the CMA. This regulations has a specific element which is related to authorised person conduct. This particular regulations involves regulations associated with churning and prohibition of trading when recommended to discontinue. These two articles which have been addressed are associated with the suitability concept and, therefore, if a broker does so, they are encroaching upon the law.

⁸¹⁴ Conduct of business obligations

⁸¹⁵ Financial Conduct Authority.

Article sixteen says “An authorized person must not advise or solicit a client to deal or deal or arrange a deal in the course of managing for a client if the dealing would reasonably be regarded as contrary to the interest of the client, having regard to the number and frequency of trades relative to the client’s investment objectives, financial situation and the size and character of his account”.⁸¹⁶ Article sixteen is centered on ‘churning’ which is defined as unauthorized trading. It continually comes along with inappropriate endorsement as a principle defilement conducted by a broker. Additionally, the article addressed and illustrated an evident image regarding inappropriateness of endorsement as it will be addressed more fully in relation to the suitability concept.

The other article is article nineteen, which is in the same regulations which points out the following “Where an authorized person or any of its affiliates issues an investment recommendation, research, study or analysis relating to a security it is prohibited from:

1) providing advice to a client or making a trade for a client that is contrary to the recommendation unless the authorized person, prior to providing the advice or making the trade, discloses to the client the recommendation and the potential conflict of interest between the authorized person and the client; or 2) Making a trade for its own account in the security that is contrary to the recommendation.⁸¹⁷

This specific regulations forbids the broker from implementing transactions in contradiction to the endorsements, or studies expect if complete admission is given to the costumer. To make this clear, essentially, this defilement is categorised as an inappropriate endorsement for the client as it is evident that the client is being represented in an incorrect manner. Transporting the discussion to an additional law, the professionals are able to depend on the authorised person applying and executing laws which discuss in depth the suitability concept to allow the claim to be stronger and more dependable. This regulations will be addressed more thoroughly further in the study.⁸¹⁸

⁸¹⁶ Article 16 of market conduct Regulations .

⁸¹⁷ Article 19 of market conduct Regulations .

⁸¹⁸ Mulhim Hamad Almulhim, ‘A Critique of Saudi M&A Laws’ [2016] P30.

6.6.3 KSA and UK Rules About Suitability

The word ‘suitability’ in ordinary language means being ‘right or appropriate for a particular person, purpose, or situation’⁸¹⁹ or ‘acceptable or right for someone or something’⁸²⁰. From the viewpoint of policymakers, there is an exact conception of suitability, which can be said to be ‘a policy judgement that investor should neither be encouraged nor permitted to invest outside their tolerance of risk’.⁸²¹ This section attempts to explain the significance of suitability in a stock market under the regulations of a securities market.

It might be a truism to say that insufficient financial recommendation would lead to misallocation of resources and therefore losses in the welfare of society.⁸²² It is for this reason that it is argued that suitability helps in increasing investor confidence through the knowledge that no inappropriate advice will be offered. Therefore, it could be claimed that suitability is a significant regulatory duty since it promotes not only the efficiency of the economy by ensuring the quality of advisory services, but also the confidence of investor that they will obtain suitable advice. Suitability as a regulatory duty shows that it designed to ensure that broker would ensure that the content of the recommendation was suitable to the needs of investor.⁸²³

As a regulatory rule, it is believed that the idea of ‘suitability’ was established in order to impose two different kinds of duties upon advisers. The first is the need to tailor suitability to specific client needs and requirements, and therefore to enable them to make informed judgments about the suitability of securities. Secondly, the suitability of a financial product to be an ‘appropriate investment’, based upon a sensible foundation and recognized as a ‘reasonable-basis suitability’. Key to suitability is that a broker should always have a reasonable belief that the securities they recommend are suitable for the client.⁸²⁴

⁸¹⁹ ‘Suitability - Definition of Suitability in English | Oxford Dictionaries’ (2014) <<https://en.oxforddictionaries.com/definition/us/suitability>> accessed 9 April 2017.

⁸²⁰ ‘Suitable Meaning in the Cambridge English Dictionary’ (2015) <<http://dictionary.cambridge.org/dictionary/english/suitable?q=Suitability+>> accessed 9 April 2017.

⁸²¹ Harvey E Bines and Steve Thel, *Investment Management Law and Regulations* (Aspen Publishers 2004)P167.

⁸²² Frederick Mark Gedicks, ‘Suitability Claims and Purchases of Unrecompensed Securities: An Agency Theory of Broker-Dealer Liability’ (2005) 37 Ariz St LJ 535.

⁸²³ Rene Fischer and Ralf Gerhardt, ‘Investment Mistakes of Individual Investor and the Impact of Financial Advice’ [2007] P33.

⁸²⁴ Loss and Seligman (n 538).

6.6.3.1 Know your Client Rules in UK

According to definition of fiduciary duty for broker that mentioned earlier, an important question arises with respect to the recommending transactions, and What a broker needs to know regarding opening a client account? In order to answer these questions examine Know your client rules in the UK, which are required by many laws of concept of knowing your client (KYC) is required client due diligence, such as that under COBS 9.2.1R and 9.2.2R, are Requires a firm to learn necessary facts about a client's knowledge and experience, such as his/her financial condition and his/her investment goals, to assess suitability.⁸²⁵

Article COBS 9.2.1R it points out that “(1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client. (2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's: (a) knowledge and experience in the investment field relevant to the specific type of designated investment or service; (b) financial situation; and (c) investment objectives; so as to enable the firm to make the recommendation, or take the decision, which is suitable for him”.⁸²⁶

According to previous article it is not very clear which information should be enough to know about broker's client . yet there is other article about Suitability which is COB 5.3 it would be more clear. Moreover, another rule can be useful which is The Money Laundering regulations 2007. Accordingly, the information might be gained a day or a month or even a year before a service is offered. However, firms should bear in mind COBS 9.2.5R in this event Nevertheless, if information has been taken in advance, broker will demand to to updating of client information.⁸²⁷

⁸²⁵ Clifford Chance LLP, ‘Guideline On The Application Of The Suitability And Appropriateness Requirements Under The FSA Rules Implementing MIFID In The UK’ (2012).

⁸²⁶ FCA: Article COBS 9.2.1R Assessing suitability.

⁸²⁷ Paul Nelson, Capital Market Law and Compliance: The Implications of MiFID (Cambridge University Press 2008) P3.

6.6.3.2 Know your Client Rule in Saudi Law

It is important for any broker or an authorized person to know necessary information before he/she accepts any client in order to open an account. Therefore, broker is required only to recommend “suitable” investments based on whether recorded information is held and has been provided by client as long as it not contains incomplete or inaccurate information about a client. So In article 39 of authorized person in Saudi, it states that “1) Before an authorized person deals, advises, or manages for a customer, it must obtain information from the client concerning the customer’s financial situation, investment experience and investment objectives relevant to the services to be provided. Such information must be obtained as a precondition to providing such services. 2) The information required under paragraph (a) of this Article must at a minimum include the information required by Annex 5.3. 3) The authorized person must request an update of such information from each client at least annually. 4) If the client refuses to provide the information required under this Article, the authorized person may not deal, advice or manage for him. 5) An authorized person must retain a record of all information obtained from the client pursuant to this Article.”⁸²⁸

This Article concentrates on present data, and is something that should be annually revised and reviewed, updating as necessary. As well as containing basic details regarding the client, this information ensures the broker can stay up-to-date with his/her client’s fiscal position, and the client’s investment knowledge and goals. Annex 5.3, for example, requests information regarding estimated annual income and net worth (excluding residence), and questions whether the client already has an up-to-date investment portfolio, if so, how he/she expanded said portfolio, the extent and quality of any previous investment knowledge, and probes what qualities the client believes create the perfect portfolio.⁸²⁹

Saudi law, however, does not disclose any data regarding institutional investor. It is important to note that Saudi law only records the following basic information from institutional client : name, address, date of registration, number of employees, capital, annual total turnover, bank details, and other financial particulars client might decide to personally discuss. Whether a client has requested a recommendation or not, in order to deliver the appropriate obligations,

⁸²⁸ Article 39 of Saudi Authorized Person Implementing Regulations.

⁸²⁹ Saudi Authorized Persons Regulations , Article 39. Annex 5.3.

the CMA has to complete any missing information, such as experience level or the role of the advisor in making investment judgments, for example.

6.6.4 Broker Dealer Suitability Obligation Regarding to a Client

6.6.4.1 The UK Rules About Client

In situations where firms deliver portfolio management or investment advisory services, the COBS 9 suitability requirements look to make sure these firms collect sufficient details about their customers to act on their behalf in a compliant way. Furthermore, that the services provided to, or for, their customers are suitable to their particular needs. A trade decision or transaction can be considered improper if this information has not been collated or considered appropriately.⁸³⁰ The FCA's Principles for firms (PRIN) (PRIN 2.1), and particularly Principle 9, are the starting point that the COBS 9 requirements expanded upon; stating that any client permitted to depend on the opinion of a firm must be able to rely on the firm taking reasonable care to make sure the advice is appropriate.⁸³¹

The TCF Principle, based in Principle 6 of PRIN, is considered central as it enshrines the basic standard that firms must deal with their customers properly and give all necessary consideration to their welfare. Copied-out MiFID text is the basis of a magnitude of the COBS 9 rules. The rule often known as the "client's best interests" rule, requiring a firm to act professionally and with integrity to achieve an optimum outcome for the client is contained in COBS 2.1.1R. Although not contained as part of COBS 9, it is never the less in the framework of suitability assessments significant.⁸³²

The FSA also referred to there being The "irreducible minimum level of information" which a personal recommendation could not be provided is based on the principle of collating sufficient necessary information to achieve a suitable recommendation, rather than the obtaining of immaterial facts. However, the method of obtaining the requirement data to determine

⁸³⁰ Lewis D Lowenfels and Alan R Bromberg, 'Suitability in Securities Transactions' [1999] The Business Lawyer 1557.

⁸³¹ Nelson (n 823).

⁸³² Kern Alexander and Niamh Moloney, Law Reform and Financial Market (Edward Elgar Publishing 2012) P25.

suitability is not advised upon by the FCA, nor therefore how businesses should collect the material required.⁸³³

6.6.4.2 The Saudi Rules about Client

Saudi Authorized Person regulations indicated the concept of suitability theory obviously, this regulations can be applied in both individual and institutional investor. However, it is not interpreted to expand the concept for institutional investor, and provide very basic information for this important category.⁸³⁴ Thus Article 43 states:

“(a.) An authorized person must not deal, advise or manage for a client or take collateral for its own account from a customer, unless the advice or transaction is suitable for that client having regard to the facts disclosed by that client and other relevant facts about that client of which the authorized person is, or reasonably should be, aware.

(b.) In reviewing the suitability of advice or a transaction for a customer, an authorized person must have regard to:

- 1) The customer’s knowledge and understanding of the relevant securities and markets, and of the risks involved;
- 2) The customer’s financial standing, including an assessment of his net worth or of the value of his portfolio based on the information disclosed by that customers;
- 3) The length of time the client has been active in the relevant markets, the frequency of business and the extent to which he relies on the advice of the authorized person;
- 4) The size and nature of transactions that have been undertaken for the client in the relevant markets; and
- 5) The customer’s investment objectives.

(c.) Notwithstanding paragraph (a) of this Article, if an authorized person has advised a client that a transaction is not suitable for him and the client decides to proceed with the transaction, an authorized person may accept an order to buy or sell the security from the customer, provided that a record of the advice provided to the client is retained.

(d.) This Article does not apply to dealing for an execution-only customer.”⁸³⁵

⁸³³ Clifford Chance LLP (n 821).

⁸³⁴ Almulhim (n 814).

⁸³⁵ Article 43 of Saudi Authorized Person Regulations.

There are some cases when a broker does not have an obligation to inform a client of the unsuitability of a recommended investment. A professional client may be advised as to market and prices with materials, discussions and views without a going as far as to "recommend" them, either professionally or personally. In this case the firm should enshrine their position with their client by detailing unambiguously that in the offering of data that no recommendation is attached. A principle question as to whether or not information imparted constitutes a recommendation is whether the client could have reasonably considered it to be a recommendation, and whether the firm presented the information in a manner that could be construed as offering a recommended approach. The contiguity, promptness or importance of a statement acting as a disclaimer will all have to be taken into account as to whether or not such a declaration can alter the nature of the communication. Should it be established that a personal recommendation was provided; a business is unable to contractually avoid the requirements of providing such a statement.⁸³⁶

6.6.5 Broker Rights

The broker plays an important role in achieving the economic interest of the State. The broker deals with financial assets, which are linked to financial institutions. Thus, the Saudi Legislator recognizes the importance in protecting the economic interest of the state and the interests of the investor. However, the broker has rights, as well, which the investor must respect.

6.6.5.1 The Right to Obtain a Commission

The broker collects a commission based on the contract with the client and peer commission fees. Saudi regime did not refer to this right directly, but obligated the broker to disclose to the client the commission due, as stipulated in Article 46 of the list of Authorized persons. The Saudi regime has set a minimum commission, has identified this amount in the Saudi market to SR 12 in any order has been implemented; it is equal to or less than the 10,000 SAR.⁸³⁷

⁸³⁶ Nelson (n 823).

⁸³⁷ Article 46 of The Saudi Authorized Persons Regulations .

6.6.5.2 The Right to Monopolize the Brokerage Business

This right is intended to ensure the sale and purchase of securities in the financial market is limited to stock broker alone; stakeholders (buyer and seller) must not enact deals without the involvement of a stock broker. This right of monopoly is limited to restricted stocks in the stock market; if a stock is not restricted, it may be traded without the involvement of a brokerage firm. The only condition is that it be announced at the stock exchange.⁸³⁸

As well as the UK legislator in Part II Regulated And Prohibited Activities under section 19 of FSMA” he general prohibition.(1) No person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is (a) an authorized person. Moreover, an Agreements made by unauthorized persons unenforceable against the other party. According to section 26 of FSMA.⁸³⁹

Under article 31 of the Capital Market Law (Brokerage business is restricted to a person holding a valid license and who is an agent of a joint stock company that is licensed to perform brokerage activities, unless such person is exempt from these requirements in accordance with paragraph (c) of Article 32.)⁸⁴⁰

6.6.5.3 Broker Right to Expenses

The broker has the right to reserve a portion of the client's funds if a balance is due and payable immediately, especially in the case of the client procrastination, and also has the right to recover the expenses incurred by the broker, which performs the process; they are often the ones stipulated in the expenses section of brokerage contract. These expenses may be administrative fees or expenses carried out by the broker as stipulated in Article 72 in the list of people authorized to Saudi Arabia. The right to recover the expenses did not refer to the Saudi regime, but it is the custom between the broker and his client.⁸⁴¹

⁸³⁸ A Alarm, Commercial Broker in Financial Transactions (Imam Muhammad ibn Saud Islamic University 1988).

⁸³⁹ Section 26 of Financial Services and Market Act.

⁸⁴⁰ Capital Market Law.

⁸⁴¹ Ahmed Al Khamisa, Broker and the Investor in Securities Trading Disputes - the Study of Doctrinal Legal and Practical (King Fahd National Library 2013) P65.

6.7 Responsibility of Broker in Saudi Law

From examining what has been discussed above, it is clear to indicate that a broker has a fiduciary duty toward his/her client. Therefore, there is a requirement to know how the law court determines and defines the fiduciary responsibilities of a broker's client. As it discussed previously there are special circumstances that illuminate what a broker dealer has to do in order not to violate his/her fiduciary duty obligations, which will be conversed in this section. A brokerage firm doing its job in the securities, trading selling and buying on behalf of its client, is taking into consideration the client's interest. This is the broker's commitment towards the client, and the brokerage must face consequences if it breaches this commitment. These consequences may take the form of either civil liability or criminal liability.⁸⁴² In a civil liability, the brokerage firm will be required to compensate the client for all damages that occur to the client as a result of a breach of the brokerage company's obligations. If the brokerage company commits a criminal offense in accordance with the capital market regulations and other related regulations, it faces criminal charges. Laws exist to alleviate abuses of the financial market as well as abuse of investor by brokerage firms.⁸⁴³

In the next two sections, it will discuss the implications of civil and criminal liability for brokerage firms in the securities.

6.7.1 Civil Liability of the Broker in the Saudi Law

A broker contract in the Saudi stock market is a binding contract for the parties of contract, and it imposes on the parties several obligations. A breach of those obligations will result in contractual liability. Moreover, the brokerage firms are responsible for illegal action, which fall under tort liability. Both civil and criminal liabilities require compensation for the damage. Breach of the obligations arising from the contract presupposes the existence of contractual link between the injured and responsible for the damage, before the damage has taken place. The illegal action or tort committed without a precedent contractual link between the injured and responsible for the damage negates the injured party's right of compensation. Civil liability

⁸⁴² Carol R Goforth, 'Stockbrokers' Duties to Their Customers' (1989) 33 St Louis ULJ 407.

⁸⁴³ Moh Ssroukh, The Legal Effects of Financial Brokerage (University of the Middle East 2009)P55.

of brokerage can be divided into three categories: wrongdoing on the part of the broker; negligence on the part of the broker; and damage and causal relationships.⁸⁴⁴

6.7.1.1 Wrongdoing on the Part of the Broker

The first pillar of civil liability is wrongdoing on the part of the securities broker⁸⁴⁵. When a brokerage fails to abide by its obligations to the investor, the brokerage is then obligated to compensate for the wrongdoing. The broker's liability is based on expected due diligence; the trial judge, with the aid of experts in the field, determines the broker's fault and liability. In this section, I will examine the most important forms of civil wrongdoing by the broker in light of the Saudi regime, as follows.⁸⁴⁶

6.7.1.1.1 Breach of the Broker's Duty to Know the Customer

As previously mentioned, broker are required only to recommend “suitable” investments based on whether recorded information is held and has been provided by client as long as it not contains incomplete or inaccurate information about a client. So It is important for any broker to know necessary information before he/she accepts any client in order to open an account. The Saudi legislator committed the broker in Article 39 of the Authorized Persons regulations : "(a) Before an authorised person deals, advises, or manages for a customer, it must obtain information from the client concerning the customer's financial situation, investment experience and investment objectives relevant to the services to be provided. Such information must be obtained as a precondition to providing such services. (b) The information required under paragraph (a) of this Article must at a minimum include the information required by Annex 5.3. (c) The authorised person must request an update of such information from each client at least annually. (d) If the client refuses to provide the information required under this Article, the authorised person may not deal, advise or manage for him. (e) An authorised person must retain a record of all information obtained from the client pursuant to this Article."⁸⁴⁷

⁸⁴⁴ AlTuwaijri (n 802).

⁸⁴⁵ Rowan Cruft and others, *Crime, Punishment, and Responsibility: The Jurisprudence of Antony Duff* (Oxford University Press 2011)P180.

⁸⁴⁶ Mark Wilde, *Civil Liability for Environmental Damage: A Comparative Analysis of Law and Policy in Europe and the United States* (Kluwer Law International 2002) vol 4 P73.

⁸⁴⁷ Saudi Authorized Persons Regulations , Article 39.

It is also the broker's obligation to ensure the customer's capacity for the conclusion of transactions; this ensures there is no valid transactions on behalf of an incompetent client, which would cause the broker to bear responsibility for harm to others involved in the transaction.

6.7.1.1.2 Breach of the Broker's Duty to Take into Account the Interests of Client

If the general rule in the regular agency, it's an exchange contract, unless otherwise agreed, meaning identifying commission which depends on the will of the parties, unlike the brokerage contract which is consider contract of exchange, thus the broker must achieve a result, and through efforts treating them fairly and paying due regard to customers' interests. Thus arises the contractual responsibility of broker, when he a breach of this obligation, which may cause damage to the customer.⁸⁴⁸

In the case of (Securities and Resolution of Securities Disputes), No. 35 / L / D 1/2007 issued in case 9/27.⁸⁴⁹ Summarizing the facts of this case, the plaintiff submitted the Commission regulations suit in which he stated that he had handed over to the defendant the certificate of shares of the Saudi Electricity Company Certificate (8551 shares), as well as the certificate of shares of Nadec Company (52 shares). So as to deposit these shares in its investment portfolio at the prosecutor's branch in the (magnificent area), in order that he can buy and sell in galleries shares or equity funds, so the prosecutor's branch sent the certificates to manage stock. After a passage of time, the prosecutor offered to ask the prosecutor's branch not to deposit the banking stocks portfolio to the plaintiff. After reviewing the prosecutor's branch in the (magnificent area) several times, the official said he had not received any response from the Depository Share Centre. The prosecutor, therefore, filed a complaint that the General Directorate of the defendant repeat the request to return the original certificates, as well as requesting compensation for the damage he suffered during the period without receiving an answer to the complaint. Consequently, the plaintiff filed a complaint to the Capital Market Authority, represented by the Committee chapter in securities disputes. In this case the broker breached its obligation to take into account the interests of the investor, and in breach of the duties of the secretariat, missed the investor stock certificate, as he was delayed for nearly seven months in

⁸⁴⁸ Mutawa (n 245).

⁸⁴⁹ Securities and Resolution of Securities Disputes: case No. 35 / L / D 1/2007 issued 9/27.

allocating the stock investor, and from disposing of his property and investment, The Commission, therefore, ordered the defendant to compensate the plaintiff in the amount of 8885709 SAR.⁸⁵⁰

6.7.1.1.3 Lack of Communication with Client

A brokerage contract requires the broker to enlighten and provide the necessary information to client in a way that is clear, fair, and not misleading, therefore, the client can make appropriate decisions. If a broker deliberately neglects to inform or enlighten the investor with information or necessary data, provides inappropriate advice, or favors the interests of one investor at the expense of another, the broker is liable for damages. This article and its contents of 43 of the Authorized Persons regulations obligates the broker, when giving advice to the client, to take into account the client's understanding and knowledge of the capital market and the risks and financial position and the value of an investment portfolio.⁸⁵¹

6.7.1.1.4 Non-Delivery of Securities or Funds to Either the Buyer or the Seller

As previously pointed out that the most important broker obligations are to deliver a stock price after the implementation of the sale or purchase for the account of investor, under the brokerage contract (contract of exchange), not all deliver any of them exempts the broker of the responsibility for the damage that may affect the client, since not give up responsibility for the price of securities sold on behalf of the client. And in accordance with Article 67 of Authorized Persons regulations . Unless paid to the client or a third party, based on the customer's instruction, or through a deposit account the customer's name, or if the money was due and payable licensee of a person.⁸⁵²

6.7.1.1.5 Failure to Inform Traders of Stock Prices

Consequent violation of the broker of the obligation determined by Article VII of trading rules in the Saudi stock market, Included in this picture contrary to Article broker (8/5) of the

⁸⁵⁰ Securities and Resolution of Securities Disputes No. 35 / L / D 1/2007 issued in case 9/27.

⁸⁵¹ Ssroukh (n 839).

⁸⁵² Harris Irfan, Heaven's Bankers: Inside the Hidden World of Islamic Finance (The Overlook Press 2015) P89.

Authorized Persons regulations, which necessitated the broker obligation to provide the client with information in a clear, fair, and not misleading manner.⁸⁵³ The trading rules in the Saudi market state that the broker should be keen to implement all client orders and then inform the client the outcome of execution, whether the implementation was successful. The notice should contain the broker email and name and number of the account and the type of security.⁸⁵⁴

6.7.1.1.6 Failure to Implement Trading Orders According to Investor Instructions

Failure to abide by investor instructions when trading is a clear violation of contractual obligations, and can cause significant damage to the investor. For example, an investor asked broker to trade on a certain security, but the broker trade instead on another security; or the broker trades on a banned security instead of permissible securities, causing the investor to lose the price of these securities or even to fall subject to legal liability. In all cases, if management of the investor's securities is not permissible according stock market law, the broker forfeits the commission, and is liable for compensation for the damage caused to the investor.⁸⁵⁵

Another example is a broker trading contrary the investor's orders by buying a security at a higher price than the price fixed by the investor, a price which the financial capacity of investor or is contrary to his expectations. Likewise, a broker trading securities at a lower price instead of specified price that asked by investor. The broker may also breach the investor's trust by trading the wrong number of securities. The damage caused by the broker's breach of the investor's order could have been avoided if the broker committed to his orders.⁸⁵⁶

Moreover, Article 12 of the Market Conduct regulations stipulates: "An Authorized person or a registered person must execute client orders for a security before executing any order for his own account."⁸⁵⁷ The broker must include in the client order the information recorded on the customer's identity and security that the client wants to buy or sell, the amount of securities covered, the terms, and whether it is the market order or a specific order. If it is a specific order, it must record the price and the period of validity of the order, and the registration and

⁸⁵³ Saudi Authorized Persons Regulations .

⁸⁵⁴ Al Khamisa (n 837).

⁸⁵⁵ Mutawa (n 245).

⁸⁵⁶ *ibid.*

⁸⁵⁷ *ibid.* Article12.

implementation of any amendments to the existing orders Moreover, the broker must execute orders on time according to the instructions issued by the investor.⁸⁵⁸

6.7.1.1.7 Breach of The Duty to Execute Trades at the Right Time

Saudi legislator committed a median speed of execution of investor orders without delay; the Article XV of the Market Conduct regulations that « An authorized person who executes a transaction based on a client order must ensure that the transaction is promptly allocated to the account of that client. An authorized person who executes a discretionary transaction must ensure that the transaction is promptly allocated to the account of the client for whom the authorized person decided to transact."⁸⁵⁹

In the case of (Securities and Resolution of Securities Disputes), No. 22 / L / D 1/2006 issued in case 26/26. The prosecutor submitted the chapter in security disputes to the Committee. In the lawsuit he gave to the broker, the plaintiff stated that he ordered the sale for one day to the number of shares of 640 of the National Industrialization Company at a price of 582. Sales demand was then implemented, and the transaction amount (372.480) was suspended for a period of 51 days; the share price rose from (509) to (975). The plaintiff demanded compensation for losses suffered because of that comment in the amount of 300,000 riyals. In this case, the broker breached its commitment to privatization in a timely manner, meaning that the amount was not allocated to the resulting sale within the 51-day stipulation; therefore, the Commission ruled to compensate the plaintiff the amount of 29,640 riyals. The Committee also felt that the broker violated his allocation in a timely manner, and that such breach required the responsibility of the violator. Neither the violator nor the defendant proved the cause of responsibility for it, and as such, in this instance, the liability here is contractual liability.⁸⁶⁰

It should be noted that the broker's commitment to the duty to execute trades at the right time is a scientific justification and legal reason for the commission. But this does not mean that the broker's commitment to perform the work, it is an obligation achieve a result, as always remain committed care and diligence.⁸⁶¹ It is obvious by the nature of the broker contract that the

⁸⁵⁸ Mutawa (n 245).

⁸⁵⁹ Saudi Market Conduct Regulations .

⁸⁶⁰ Securities and Resolution of Securities Disputes No. 22 / L / D 1/2006 issued in case 26/26.

⁸⁶¹ Ganr Atrophy, Criminal Responsibility for Non Legal Acts of Stockbroker (University of the Middle

stockbroker is not obligated to implement the deals, as its commitment to ensure the safety of these deals , unless there is an agreement to the contrary of that, which led to the extend the scope of its commitment to the implementation of the deal at a specific date. If a broker is delayed in depositing amounts resulting from the sale or purchase deal in the investor's account, whether this delay is due to either a technical defect or any other reason, the consequent inability of the investor to access his money causes him harm. Therefore, the financial broker shall indemnify the investor for the opportunities missed because of the imprisonment of his money.⁸⁶²

6.7.1.1.8 Failure to Notify the Investor of the Outcome of the Investor's Orders

It has already been mentioned that the broker must abide by the commands given to him by the investor; in addition, the investor must notify the investor of outcome of its implementation of these orders. As required per the trading rules of the Saudi stock exchange, the broker must send periodic notice to the investor indicating the processes that has account during that period.⁸⁶³ The broker must also a statement at least every three months, which shows all transactions and activities that took place during that period. The statement must include the broker's name, the client's name and account number, the type of securities and the type of transaction (sale or purchase), the settlement date, the commission, and other details. The broker is liable for all damage caused to the investor as a result of the broker's failure to fulfill the duty of notifying the investor of the outcome of implementation.⁸⁶⁴

In the case of (Securities and Resolution of Securities Disputes), No. 100 / L / D 1/2007 issued in case 108/27. The prosecutor offered the regulations suit to the Committee chapter in securities disputes, pointing out that the client saw the portfolio and did not find its shares owned by the Nadec company network of 5,000 shares. In addition, that the client stated that it had been sold without his knowledge, and the transaction amount had been allocated in the two months after his account of the sales process! The prosecutor asked for compensation by

East 2009) P76.

⁸⁶² Poser and Fanto (n 768).

⁸⁶³ A Fawn, The Legal Status of Broker in the Stock Market (Baghdad University 2009).

⁸⁶⁴ 'How a Broker Provides Suitable Recommendations to His/Her Client : (2010) <<http://www.mohamoon-montada.com/default.aspx?Action=Display&ID=108593&Type=3>> accessed 5 April 2017.

giving the difference between the sale price of 435 and the highest share price reached when the amount of deposit in his account on 2005/80/10, and demanded compensation for this error and expenses for the establishment of a lawsuit by 20%. According to the investor in the first package instructions, it violated his broker that executes orders, and also violated his allotment at the right time in the second deal. The Compensation Committee decided, and so skipped the opportunity to the investor, who therefore did not benefit because of the mediator in the allocation of the amount, and contrary to the broker delayed investors' orders by 44541280 Real.⁸⁶⁵

6.7.1.1.9 Failure to Ensure the Availability of the Stock Price in The Investor's Account Before the Implementation of the Deal

One of the most prominent contractual errors that may be committed by the broker, and damage the client or other party in the deal, is to fail in the duty of ensuring the availability of the stock price in the investor's account before the implementation of the deal, especially if the value of these securities is great, or if there was doubt in the investor's ability to complete this transaction. It should be noted that such a commitment has been confirmed by the trading rules which necessitate the broker to ensure that all supporting documents are in the correct format, and the broker is responsible for any defects in delivery of shares, or non-payment by the buyer of value.⁸⁶⁶

6.7.1.1.10 Disclosure of Confidential Information of the Investor

The broker is required to keep confidential the investor's information. Failure to do so is a breach of contract for which the broker will be held liable. It should be noted that the Saudi legislature may ban such acts, but the Saudi laws do not specify images or methods of disclosure of secrets.⁸⁶⁷ This type of breach is described as *the disclosure* in the labor Law and the Banking Control Law, and the corporate Law uses the wording disclosure of confidential information. But the law does not specify means of disclosure of confidential information, or

⁸⁶⁵ Securities and Resolution of Securities Disputes No. 100 / L / D 1/2007 issued in case 108/27.

⁸⁶⁶ Mills Charles, 'The Client Relationship: Suitability, Unauthorized Trading, and Churning' (2007) P349.

⁸⁶⁷ Poser and Fanto (n 768).

how it is done, and that the text was that the disclosure is prohibited (in any way) in the Banking Control Law.⁸⁶⁸

The emphasis on civil responsibility in the Saudi regimes is mentioned in Labor and company's laws, where Article (83/9) of the Saudi Labor Law says, "If the work assigned to the worker allows him to get acquainted with the employer's customers, or to have access to his business secrets, the employer may require the worker in the contract not to compete with him or reveal his secrets upon expiration of the contract. For this condition to be valid, it shall be in writing and specific in terms of time, place and type of work and to the extent required to protect the legitimate interests of the employer. In all cases, the duration of such agreement shall not exceed two years from the date of termination of the relationship between the two parties."⁸⁶⁹ As for trading in the stock market, the Saudi Labor Law stipulates in trading market rules that the broker must treat client information as strictly confidential, except in cases in which the law requires disclosure. Thus the broker is liable for damages caused to the client as a result of the disclosure of secrets; especially if this led to damage to his financial or commercial reputation.⁸⁷⁰

6.7.1.2 Negligence of Responsibility of Broker

The civil tort takes place in the case of breach of a legal duty, which represents the need to do no harm to others. The broker is required to compensate the injured for damage; the basis of civil liability in Saudi Arabia regimes is wrongdoing.⁸⁷¹

It should be noted that these laws take the idea of "warranty" known in Islamic law, which is based on the idea of compensation for infringement of the offer or, and which corresponds to the idea of wrongdoing in the law. As the wrongdoing is a violation of the rule of law, to commit an act or refrain from doing; and therefore it becomes an unlawful act. The tort liability's pillars do not differ from those in contractual liability, as it extends to the wrongdoing

⁸⁶⁸ E Ghamdi, Duties of Insurance Broker (University of Southampton 2002).

⁸⁶⁹ Article (83/9) of the Saudi Labor Law.

⁸⁷⁰ Mutawa (n 245).

⁸⁷¹ Poser and Fanto (n 768).

-tort- which lies directly from the delegate has his works, and the consequent damage to others, So in this section will address the tort of financial institutions for their wrongdoings staff.⁸⁷²

6.7.1.2.1 Broker's Responsible for the Wrongdoings of his Employees

The punishment is personal, the person only asks for what he/she did, but it has appeared justifications by regulator believe that such as responsibility for these actions is towards other, whether this third party or one of who is under his responsibility. Moreover, the economics field is fertile ground for the application of the idea of responsibility for wrongdoings of employees, to the extent that it has become seen as a general rule in the laws of economics.⁸⁷³

It is worth mentioning that the Saudi legislature has stressed the responsibility of brokerage firms for their employees' mistakes, and it obligated them to establish a committee called "matching," in which brokerages monitor employees and ensure their commitment to the process of trading rules.⁸⁷⁴ This, along with their submission to the management of the company, shows the importance of the role played by these workers in the capital market. Therefore, the broker will be investigated for every act that is not correct with the statutory provisions, or generally in line with the rules of honesty, integrity, or generally accepted practices in financial market among broker in financial securities. The worker at a brokerage firm who commits crimes such as practicing without a license, impeding Market Authority monitors, or manipulating stock prices, places upon his employer the criminal responsibility for his actions.⁸⁷⁵

The basic principle is that the broker (master) can require the (follower) to pay some of the compensation which was paid to the client; however, the broker (master) owes the (follower) some of the amount. This is achieved if (master) commits self-wrongdoings separate from the wrongdoings of (follower), and that wrongdoings may have contributed to the occurrence of the damage. If (follower) proves that the broker has participated with him in the wrongdoings, the two will divide the compensation.⁸⁷⁶

⁸⁷² *ibid.*

⁸⁷³ 'How a Broker Provides Suitable Recommendations to his/her Clients:' (n 860).

⁸⁷⁴ Mutawa (n 245).

⁸⁷⁵ Poser and Fanto (n 768).

⁸⁷⁶ GHAMDI (n 864).

6.7.1.3 The Damage and the Causal Relationship

All three pillars must be achieved for responsibility to be assigned; it is not enough for the broker to commit wrongdoings. There is no responsibility without damage. Damage to customers of brokerage firms is divided into moral or material damage. Material damage is caused by the broker's breach of contractual obligations that leads to the client missing an opportunity or preventing a client from avoiding a loss that could have been avoided if the broker had implemented his orders appropriately.⁸⁷⁷

In all cases, it required for entitlement to worker compensation for this damage, but the damage must be an investigator , it must be an investigator to fall in the future, As it does not compensate for the potential damage as the client does not have the right to claim compensation for the damage, but the expected direct by the broker.⁸⁷⁸ Moral damage to the client is non-financial, such as damage to the client's personal or business reputation, resulting in the right to compensation in the face of the company's brokerage causing this damage. With regard to the corner causal relationship is the third pillar of civil liability, which would not be complete without it, and that must be established between the wrongdoing and what the right injured of damage. Even when there were many causes of damage to a client, when the broker fails to catch these causes and prevent damage, the broker is responsible. In all cases, a causal relationship is assumed, and thus the broker is not responsible for the client's compensation unless the client proves that the annexes of the damage were the result of the strength or sudden accident is impossible to push or was the result of wrongdoings by the client himself or due to the non-fault.⁸⁷⁹

6.7.2 The Effects of Civil Liability of the Financial Broker

When the pillars of the civil liability of the broker are available of the wrongdoings and the damage and causal relationship, the broker is obligated to compensate the injured for damage, in the form of payment of a sum of money to the injured. Whatever the nature of the damage, the injured has the right of access to justice - Committee for the Resolution of Securities

⁸⁷⁷ Al Khamisa (n 837).

⁸⁷⁸ Mutawa (n 245).

⁸⁷⁹ *ibid.*

Disputes (CRSD)⁸⁸⁰ - as prosecutor of lawsuit of civil liability of broker. If the general rules permit the parties to the contractual relationship to agree to amend the scope of the contractual obligations of the debtor, so it can be dispersed or mitigate or exemption with him.⁸⁸¹

As the rules of civil liability of contractual are not attach with public order and morality, as the rules are complementary to the will of individuals. But it may not be agreement on the exemption from the ideological responsibility of the financial intermediary or mitigated. This is what was taken by the Saudi legislator in a lot of rules and regulations which stipulates the broker's responsibility obligations, and so it has been found that the Saudi Capital Market Authority stipulates that in Article 31 of Authorised Persons regulations " Any condition providing for the exclusion or restriction of the liability of an authorised person, whether under terms of business or otherwise, shall be void if the exclusion or restriction contravenes the authorised person's obligations under the Capital Market Law or the Implementing regulations .⁸⁸²

As for tort Director, may not be in agreement on the exemption from liability for an unlawful act, and what he sees is a researcher also applies to tort broker, as the tort liability provisions relating to public order and morality.⁸⁸³

6.7.3 Criminal Responsibility of the Broker in the Saudi Law

Given the importance of the economic role played by the stock market, and given the size of the capital, operating in the market, as well as the number of dealers in the market, from various segments of society,⁸⁸⁴ it has become very important to the investor of stock market to protect and trust, as well as to maintain the integrity and transparency of transactions that take place, and to achieve equality between the different segments of investor through the criminalization of certain illegal practices which may perpetrated by the financial broker.⁸⁸⁵ Currently there is not sufficient administrative oversight to achieve the stated objectives. In this sense, it has been

⁸⁸⁰ CRSD: a professional and specialized body with an accelerated performance in line with the nature of such transactions within a capital market full of variables affecting the pace of its performance.

⁸⁸¹ 'How a Broker Provides Suitable Recommendations to his/her Clients:' (n 860).

⁸⁸² Authorised Persons Regulations .

⁸⁸³ 'How a Broker Provides Suitable Recommendations to his/her Clients: (n 860).

⁸⁸⁴ Hafer and Hein (n 105).

⁸⁸⁵ Fawn (n 859).

found that the Saudi legislator did not lose sight of this important issue, from the need to provide criminal protection to the stock market and traders. When you look into the financial market system, , it has been found that the offense of many of the acts and practices that would prejudice the principles that are by transactions in the financial market, and the harm it and dealers in various categories.⁸⁸⁶

6.7.3.1 The Practice of Brokerage Business Without a Licensee

It has been realized from the above that the Saudi regulator obligates the involvement of a broker in certain transactions in securities market, and this broker is represented by the brokerage firm. The broker and the firm must obtain a license to practice brokerage by the competent authorities.⁸⁸⁷ Customers do not need to extract this license from the fulfillment of certain conditions and requirements that have been mentioned in the system, but there are still people who will exercise this profession without a license and cheat as an authorised person, who shall perform brokerage activities without obtaining this license, fooling customers and plundering their money unjustly.⁸⁸⁸

The broker may have a license that has expired, and has not been renewed; in this case, the brokerage is doing business without a license. This is what will be put in this research through formal element in the Saudi regime, and after that with the researcher is exposed to the material element in the second section, to the extent it relates to the crime or not, down to the mental element in Section III. Regulars corner: Texts that criminalize the practice of brokerage business without a license in the Saudi system, it is the requirement to the legislator, to extract licensing requests, It shows in the last section of brokerage in the sale and purchase of securities, limited the scope of his practice to obtain a license to practice the activity of brokerage.⁸⁸⁹

Brokerage business in the Saudi law is limited to licensed companies with Article 31 of the Capital Market Law: "Brokerage business is restricted to a person holding a valid license and who is an agent of a joint stock company that is licensed to perform brokerage activities, unless

⁸⁸⁶ 'How a Broker Provides Suitable Recommendations to his/her Clients: (n 860).

⁸⁸⁷ Ssroukh (n 839).

⁸⁸⁸ AlTuwaijri (n 802).

⁸⁸⁹ *ibid.*

such person is exempt from these requirements in accordance with paragraph (c) of Article 32"⁸⁹⁰

Physical corner. These crimes take place in brokerage business without prior authorization from the Saudi Capital Market Authority, based on the cancellation of licenses for one of the reasons set forth in the laws. This is the crime that take place as soon as do the physical behavior of the offender without requiring legislator achieved a certain percentage,⁸⁹¹ The legislature is not required to achieve any results in significant damage to this behavior, but the problem in the Saudi regime is considered such a crime, it is habitual crimes, requiring repeat the implementation of many similar acts to the crime. The crime of doing business brokerage without a license is a positive crime, is a continuous crime for the continuation of direct activity without a license. It also does not need to do a certain number of similar acts, it is sufficient to provide a service (administration), for example, only twice to others without the required license, for a crime other than the Saudi regime, which is required to occur three times and more.⁸⁹² Moral pillar : There are differences between the scholars of the law to require the mental element of the crime of brokerage business without a permit, there is Ray believes that this crime is enough to get you, at the time of the physical behavior, as one of the crimes legislation, without the need to prove the mental element.⁸⁹³

This view is enough to get this crime just practicing any activity, it is contrary to the provisions of the Saudi legislator. As for the opinions of others who see, there is no room to say preclusion mental element in the physical crimes and the crime of which, as one of the economic crimes organized by the legislator accurately, the duty of individuals to follow the behavior of the legislature. If the person violates stipulations by the legislature, which is a breach and violation of the legislative order, both o negligence or failure to familiarity with the orders of the legislature. This view is regarded as most correct researcher, and therefore accused may pay the absence of the mental element of the crime when it was not the world of the need to extract the license for practicing the activity. However, a crime to disclose inside information and price manipulation, and the crime of trading based on inside information and the crime of publication of false rumors relating to securities, have all been reported in detail in chapters V and VI.

⁸⁹⁰Capital Market Law, Article 32,31.

⁸⁹¹ 'How a Broker Provides Suitable Recommendations to his/her Clients:(n 860)

⁸⁹² Atrophy (n 857).

⁸⁹³ Mutawa (n 245).

6.7.4 Conclusion

In the interests of increasing investor protection, the aspects and consequences of the responsibility of the financial intermediary and fiduciary relationships, and the duties owed by the broker to their client, have been explored in this chapter.

This chapter discussed the question of whether or not the broker owes a fiduciary duty towards his client by exploring the legal implications of the broker, represented by the commitments and the broker's rights, and arising from the implementation of the work within the market and the market broker agreement with its client. It has been concluded that a broker owes a fiduciary obligation to their client. As it is seen in Saudi market law a broker must adhere to the seven obligations that clarify their responsibilities in order not to breach his or her obligation of fiduciary duty.

It has been found through this chapter that obligations ensue broker in the face of his client under the agreement between them, and that came in order to ensure the safety of financial transactions, keeping the rights of client. It also shows that the broker has several rights under the law and contracts for mediation concluded with its customers. Brokerage is the overall regulatory process, aimed at reconciling the will of both the seller and the buyer, under the rules of the financial markets, carried out by someone known as a financial broker, who receives financial compensation in so-called "commission."

It is a brokerage contract from netting exchange contract for both sides, and arranges obligations and reciprocal rights between peripherals, allowing each party to refrain from implementing the obligations, until the other party performs obligations return. The obligations of the financial broker under the brokerage contract impasse safety operations that it has undertaken within the stock market, the opening of independent accounts of its customers, and introduce them to the depository center electronic systems, and implementation of client orders and not be exceeded, and obligations rules of professional conduct imposed by the legislation and the rules of the stock market.

under Saudi Arabia law, fiduciary duty contains comparable ideas. In Saudi fiduciary duty is undoubtedly defined in its implementing regulations. The clarity of this statement ensures both

the investor and the broker fully comprehend the meaning and implications of the notion. Suitability is a factor of both laws that has been discussed in various areas with diverse uses.

In 2003 the Saudi Capital Market Law did not have to consider suitability. Nonetheless accounts of security fraud provided the CMA with an occasion to review and update existing regulations. These regulations noted the suitability concept within different guidelines, observing that some cases were guilty of positing unsuitable recommendations. Not including the CML rule, these regulations do not indicate whether or not the scienter factor is essential for successful claims; for professionals this causes ambiguity. Additionally, there are no standard regulations or guidelines issued by the Saudi Exchange, and as such there is no example for comparison in the Saudi stock market. Resolving cases is, therefore, problematic with people having to rely on self-judgment.

According to Saudi stock market regulations it is clear to indicated that a broker has a fiduciary duty toward his/her client. Therefore, the broker's commitment towards the client, and the brokerage must face consequences if it breaches this commitment. These consequences may take the form of either civil liability or criminal liability. such as the practice of brokerage business without a license is crime in the Saudi stock market regulations. Moreover, Civil liability of brokerage can be divided into three categories: wrongdoing on the part of the broker; negligence on the part of the broker; and damage and causal relationships. Also, the burden of proof is on the investor through proving wrongdoing, damages and the causal relationships. Both civil and criminal liabilities require compensation for the damage.

It should be adding the adaptation and causation of Sharia to the Commission chapter in securities disputes decisions and not just the legal causation only, especially that the first article of the Constitution states that the Quran and Sunnah are the country's Constitution as the causation legitimate would be convince the prosecutor and defendant. also, there must be a general principles and standards for the provision of the compensation cases.

The Saudi legislator's organization of the brokerage through the legislative system handled transactions that take place within the stock market, which in turn led to the organization of the work of broker, as this group formed an essential building block in the construction of a modern stock market, contributing to activate the financial system, which had a positive effect on the protection of investor. But the texts on work brokerage, spread between the stock market and

the instructions and regulations issued pursuant, which will lead to repeat many of the provisions in this legislation.

The Saudi stock market system needs to give the text of the brokerage firm, the right of priority on the securities purchased or sold securities at a price, to be able to fulfil their rights, noted that the Saudi law guarantees the right of the investor in detail reflects the right broker. Reformulate brokerage firm commitments in the Saudi regime, and collected arranged in the special section in the list of authorised persons instead of dispersion between the material and the paragraphs of the stock market system, is necessary to strengthen the oversight role of the Capital Market Authority to the brokerage firms.

Chapter 7: Conclusion and Recommendations

The 7th and last chapter has been divided into three sections; it will be started with the Summary of thesis and then conclusion of each chapter in details and highlighted them; finally, suggestions will be highlighted as well as recommendations for further research.

7.1 Summary

One of the chief goals of this thesis has been to outline the current regulatory in the Saudi Arabian stock market by way of a regulatory analysis. This has been carried out with the purpose of determining the degree to which a series of examined regulatory features afford investor with sufficient protection, thereby reinstating their confidence in the framework of the Saudi stock market.

To guide the achievement of the present work's underlying aim, four main objectives were stated at the outset: first, to identify viable ways in which the efficaciousness of the current regulatory measures can be improved, thereby facilitating appropriate investor protection with respect to the issues of market abuse, fraudulent broker activities, and ineffective information disclosure; second, to determine how the confidence of investor can be improved in conjunction with the enhancement of market attractiveness; third, to gain insight into the etiology of the last Saudi stock market crash, thereby illuminating how a similar situation can be avoided in the coming years; and fourth, to produce and outline beneficial information that can be used to guide subsequent Saudi capital Market Law (2003) reforms.

It is important to recognise that while comparable objectives underpinned the introduction and legislation of the Saudi capital Market Law (2003) s (2003) and their related regulatory measures, the present thesis has centred on four primary considerations. The following constituted the rationale which motivated their selection: first, it was noted that they constitute the critical regulatory targets in almost every world nation, primarily because they function as the foundation of investor protection; second, the literature identifies the considerations as important contributors to the historical Saudi stock market crash; and third, as maintained by the present author, each consideration poses significant concerns for the existing regulations of the Saudi stock market from the viewpoint of investor protection. The four considerations can be outlined in the following way:

- (i) The 2006 Saudi stock market crash underlined the prominent causal role played by ineffective transparency and insufficient information disclosure among listed firms. Moreover, since information disclosure is a critical determinant in guiding decision-making in the context of investment, reasoned and well-formulated regulatory measures governing the nature of disclosure must be present to facilitate investor protection. This thesis has sought to identify what these measures are.
- (ii) A further fact revealed by the crash was that insider trading is rife within Saudi Arabia, thereby meaning that unambiguous and stringent principles for the realisation of transparency and the avoidance of information diversion are required to afford protection to investor. A weak regulatory environment, devoid of precise measures intended safeguard investor against insider dealing, is a fundamental determinant of market instability. Hence, the researcher has used this thesis to identify the degree to which the supervision and counteracting of insider trading in the Saudi stock market is a viable way to facilitate investor protection.
- (iii) Investor confidence in a stock market is invariably diminished when market manipulation contributes to adverse impacts that detract from a consistent principle of equitability and justice. In view of this consideration, it is necessary for Saudi Arabia's capital authority market to implement suitable regulatory systems with the aim of identifying, examining, and exacting penalties on those who engage in manipulative market activities. Ultimately, this will facilitate market stability against future financial crises, thereby providing investor protection. With this as one of the fundamental starting points, this thesis evaluated the existing system with respect to regulatory market manipulation in Saudi Arabia, proceeding to discuss the degree to which they are suitable in achieving the desired end.
- (iv) Broker play a prominent role because they function as intermediaries with respect to the private investor who seek to purchase shares, on the one hand, and the entities which sell such shares, on the other. One of the key characteristics of a well-functioning stock market is that broker conscientiously and faithfully fulfil the requests submitted by their clients, and this is critical because the origin of stock exchanges can be attributed to the desire to exclude irresponsible practitioners from positions. Since broker conduct is, therefore, significantly linked to the well-being of a stock market, this author has attempted to assess the regulatory obligations that apply to brokerage, thereby illuminating viable ways in which to facilitate investor protection.

Hence, in view of these considerations, it has been the main aim of this thesis to determine the degree to which the current regulatory environment pertaining to the Saudi stock market affords investor with sufficient protection against ineffective information disclosure, insider trading, and market manipulation (driven in part by the brokerage business).

In order to examine these sensitive issues, this thesis first examined whether or not the disclosure regulations of the Saudi stock market provides adequate protection to investor and secondly assessed the effectiveness of the legal framework of insider trading regulations for preventing insider trading. Third, it ascertained how well the the law defines market manipulation and covers the most common forms of market manipulation under Saudi securities law. Lastly this thesis explored the responsibility that broker in the Saudi stock market have to achieve the greatest degree of protection for investor.

7.2 Conclusion

An evaluation of the regulations of the Saudi stock market the following conclusions can be drawn.

Chapter 1: Introduction

Chapter One provided an overview of the means used to ensure the thesis met its aims, by outlining its design and methodology, its restrictions and range - which were to analyse how investors' interests can be safeguarded on the Saudi stock market, under securities law.

As noted in this chapter, many authors of modern applied economics studies, such as Cameron, Gurley and Shaw, and more recently, Levine, confirm that a close relationship exists between the evolution of stock market and rates of economic growth. Stock market generally support economic growth and development through a number of their economic functions. Nevertheless, the absence of adequate financial sector policies and a developed financial system can produce disastrous outcomes, as illustrated by global financial crises. Moreover, a strong domestic financial system should therefore be appropriately maintained to enable countries to cope with the risks associated with globalization in general and the global integration of financial markets in particular.

As emphasized in this chapter, Stock market can promote social and economic development as they help form connections between groups of individuals and the projects or spheres they consider most valuable. In much the same way as a water drop cannot undergo evaporation from earth to atmosphere and cannot fall to the earth as rain if it is taken out of its natural cycle, stock market cannot benefit anyone if it is not in circulation. Finance and investment seekers will try to satisfy their needs overseas if they are not provided with suitable opportunities and protections by a jurisdiction.

Furthermore, this chapter noted that while a minority of people see no reason to regulate the stock exchange, there is a growing tide of opinion which is pushing for both intervention and regulations in the market. For any developing market to be commercially successful in the long-run, it is of great importance to implement robust securities regulations focusing on stock market development and investor protection. As has been observed by many researchers, the level of development of the general legal system associated with every jurisdiction is reflected to a significant degree in the level of protection that investor in the securities markets of a certain country are given.

As explained in this chapter, the evidence supports the fact that stock market robustness is dependent on legal standards. In an effort to make their regimes stronger, countries throughout the world are giving priority to the development of supporting institutions and a system of implementation capable of stopping transgressions such as, insider trading and market manipulation. Additionally, a legal regime that promotes disclosure and protects investor is essential for stock market to develop effectively.

Protection the market against crises is highly important, as discussed in this study. One strategy for avoiding crises is effective self-regulations. From this perspective, it is critical for the CMA to evaluate whether its resources are capable of identifying and dealing with systemic risk accumulations. Thus, self-regulatory organizations (SROs), such as stock market which are not regulated by external bodies, have grown and developed gradually. This study determined that many developed countries use the Government Model to regulate their financial markets, with securities being regulated by an external public authority, so that the exchanges do not play a significant role in controlling and overseeing their markets.

The UK uses the Government Model, hence the London Stock Exchange is self-regulating and

the FCA regulates securities, and Saudi Arabia decided to implement this model in 2003. The legal systems differ between Saudi Arabia and the UK, but it is possible to draw parallels and make comparisons between the two countries' regulations, since neither relies on case law. In the UK, financial legislation stems from statutory and not case law; in Saudi Arabia, codified systems, which include Shari'ah law, are used to draw up regulations.

Chapter 2: The Historical and Evolution of Saudi Stock Market

This chapter started by demonstrating Saudi stock market's legislative, functional and organizational features were assessed in terms of their historical development. Enhancements to regulations as the stock market has developed were considered, which contributes to the existing literature focus.

As chapter 2 explore, the rules and policies relating to Saudi's stock market have evolved in a number of phases. Changes to the stock market were promoted and introduced as a result of the 2006 crash in the Saudi stock market, therefore its significance as an event to Saudi's economic and general history means that issues relating to it are also investigated here to encouraging the development of the stock market and most importantly to protect investor.

An incredible expansion of Saudi stock market has been witnessed, despite its relatively brief duration of operation. Across the Arabic-speaking states, Saudi stock market has become the largest, achieved within a 15-year period. Three important phases of the stock market's expansion are discussed in this chapter. The contemporary context and potential for reformation of the stock market is thus thoroughly informed by the market growth assessment.

The factors discussed in this chapter demonstrate the significant effect they have on the Saudi of the stock market as well as that the collapse of the Saudi stock market was caused by directly and indirectly related factors. Also, these issues were selected because they are key targets for regulations in virtually every country and considered as the elements of protection for investor.

Saudi stock market's administrative, structural and functional features were lacking, as the 2006 stock market crash made clear. Saudi has rarely seen such an economic calamity, which was not responded to in an effective manner by the CAM, or identified as a possible even prior

to it happening. During the previous thirty years, a fast growth in the market has been seen. Participation and merging with global capital markets, organisations' growth, market volatility, concentration, liquidity and magnitude are all standard variables for assessing stock market growth.

Because market trading and speculation were not promoted due to insufficient disclosure regulations, while engagement of bigger institutional investor was lacking, for the first half of the 1980s there was somewhat sluggish stock market growth. Therefore, enhanced market liquidity and size were significantly enabled by the greater need for assets, following the increase in Saudi-based institutional investor. Considerable expansion of the market has definitely occurred. There was a 32-times growth in trading's value, volume and transaction amount over the period of 1985-1998. Throughout the region, the biggest market is clearly Saudi Arabia, with a 160% expansion in market capitalization. Nevertheless, when considering other developing states' market growth, Saudi market growth is somewhat less impressive, despite being significant in the region.

Chapter 3: Stock Market Disclosure

In chapter four the encouragement of investor assurance was assessed with regard to the existing disclosure and listing/corporate governance regulations. Furthermore, Saudi stock market's disclosure regulations were evaluated for any trends, which was the main objective of the chapter.

Disclosure received minimal attention until the more contemporary period. The extent to which a sufficient body of disclosure regulations exists in Saudi stock market is examined here. The extent to which the requirement of investor to access significant information will mean original regulations must be created, as well as the shortcomings in the existing disclosure regulations, is assessed.

This study discovered that there are a number of frequently overlapping rules which determine how information is disclosed, including rules relating to listing and corporate governance. If securities are to continue being listed then essential, precise information must be disclosed clearly at an opportune time, since this practice will allow the stock market to function in a

systematic way. This chapter underscored the importance of not merely framing disclosure rules, but also applying them.

As chapter 4 explore, Investment decisions taken by joint-stock companies' investor and other interested parties, are largely informed by the information that is accessible relating to market efficiency, as previously stated. Consequently, the choices made by an investor will be more effective if they have information that is relevant to make them, which can be provided through releasing provisional financial reports. Because stock values can be influenced by the information comprising these reports, investor should have access to them. Intermittent assessments by companies were found to lack principles for transparency and meaningful disclosure, while questions were raised regarding the influence that companies exerted on the auditing process.

In Chapter Four, a series of rules which could help to protect investors' interests were considered. These include: disclosing company long-term strategies; Director Responsibilities; Disclosure of Material Information; Rumours/Risks and the Duty of Disclosure and, finally, disclosure of the directors', bonus structures.

Saudi stock market's listed companies would be likely to gain greater assurance regarding their financial statements, when their operations and financial prospects receive sufficient disclosure, as is apparent from the chapter's conclusions. Furthermore, the Board of Director's bonuses and relevant financial information disclosure, alongside reducing harmful coverage through adequate risk disclosure, are crucial factors. In this manner, shareholder and manager clashes of interest can be identified, while any chance of deceit will be diminished leading to a stronger investment environment. Additionally, protect investor will be aided by the reduction in illegal investments.

This chapter noted that, a standardized financial statement that has been assessed by an auditor with the necessary qualifications must be supplied by organizational managers. This would indicate that investors' worries about financial reporting are given due consideration by companies. Furthermore, since financial information may be perceived as less credible if it is interfered with excessively, managers must operate within clearly established boundaries and must not be allowed to become involved in financial reporting beyond those boundaries. This chapter also noted that there is shortcut in the regulations led to a lack of clarity such as

regulations, regarding how to deal with rumours and article regarding disclosure of material information

Laws have to be enforced if they are to be followed, and anyone who disregards and contravenes the information disclosure regime is thus liable to one of three types of punishment: charges of civil or criminal liability or administrative sanctions, which have been evaluated in this chapter. It would be more effective to use a mixture of the available sanctions, depending on the type of breach involved. The harshest penalty will come from being subjected to criminal sanctions, which are intended to act as a disincentive, since individuals' careers, social standing and reputations will suffer. In these cases, the burden of proof rests with the prosecution and is high, since it involves establishing guilt beyond reasonable doubt. Civil and administrative sanctions have a lower deterrence value, and also demand a lower standard of proof.

Criminal liability empowers the authorities to charge individuals for non-compliance with the rules of disclosure, both for violation or simple non-observance of the rules. Criminal sanctions should be reserved for cases involving fraudulent behaviour, and giving false or deceptive information, in order to circumvent complying with the disclosure requirements. If found guilty, the individual can be fined or even sent to prison.

Administrative sanctions are brought to bear by the administrative body whose rules have been breached, and are not resolved in a court of law, but by a disciplinary committee. Regulatory bodies are given the legal power to impose sanctions by the law, but they do not have to follow court processes or defer to procedural assurances, such as an individual's right to a fair trial. Administrative sanctions include imposing fines and suspending or cancelling a listing on the stock market – but they cannot imprison transgressors. Investors decide where to place their money according to the information they have at their disposal, so fair disclosure of information is vital to protect their interests and to create an equitable environment in which everyone has the same access to relevant facts, and in an equally apt.

In conclusion, to answer the research question in terms of disclosure, the capital market law and its regulations partly succeeds in protecting investor by mentioning fair disclosure as one of the Act's objectives. However, there are some problems in enforcing disclosure rules, as mentioned before.

Chapter 4: Insider Dealing

Chapter 5 looked at a crucial element in protecting investor – the issue of insider trading. The UK and KSA frameworks with regard to insider trading control are analyzed in this chapter as the central focus. Furthermore, the regulations to prevent illegal activity of insider trading is analyzed in terms of its complexity, shortfalls and success, in both the UK and Saudi Arabia, as a means of providing a larger legal framework to insider trading.

Insider dealing is a contentious subject, which divides authorities and researchers. Some people believe that it is impossible to legislate against insider trading in terms of securities law; nevertheless, it is banned, albeit in a variety of ways, in most countries. It is impossible to legislate against insider dealing without defining what the term means, clearly and concisely. To do so, the following questions need to be answered:

- Who is an insider?
- What is inside information?
- How is inside information transferred?
- What actions are banned?

This chapter noted that, the category insiders used to be divided between primary and secondary insiders. This is no longer the case, since most legislation does not acknowledge this division when defining insiders. The process of prosecution, the motives behind and form of punishment, evidence required and nature of the unlawful act will all influence how the incident of insider trading is characterized. Releasing inside information, allowing individuals to gain from inside information, acquiring personal advantage and dealing, are the four main categories of illegal action. Thus an illegal act of insider trading has been committed when one of these restrictions is breached.

As a result of the conclusions drawn from this chapter, Compensations can be sought, through filing a lawsuit requesting compensation, by the individual impacted upon by insider trading. Any request for compensation is subject to the general rules of litigation. In terms of insider trading and the pursuit of compensation, general rules is applied in such instances of unlawful action, as Saudi law lack specific processes. Therefore, it is advisable to classify special measures to encourage the dissemination of any information that could have a considerable

effect on stock prices.

With regard to invalidate action in lawsuits dealing with outlawed shares of joint-stock companies, legal proceedings can be initiated on a variety of bases in Saudi Arabia. These include breach of a legal obligation, breach of the duty of fiduciary, and the disclosure of confidential information or trade secrets. However, breach of legal statutory misrepresentation, breach of fiduciary duty and breach of confidence and/or trade secrets are all justifications for triggering legal proceedings, in relation to trading based on inside information.

From the results of this chapter, in contrast to civil and criminal sanctions, the most minor sanctions that can be handed down, while also being the most straightforward, are administrative. These are largely not related to monetary compensation or fines. However, insider trading is unlikely to be prevented via such punishments. Therefore, although compensation can be awarded through common and civil law mechanisms to redress any harm done, the continuation of insider trading is unlikely to be deterred. Consequently, compensations need to be accompanied by effective deterrence measures, as part of the drive to legislate against insider trading.

This chapter discovered that, better implementation of regulations relating to the Saudi stock market is undermined by there being an absence of enforcement bodies with real power. Therefore, the growth of the stock market and greater investor confidence will be possible by increasing the enforcement capabilities and controls that the relevant bodies possess. Within the Saudi stock market, insider trading regulations' success is affected by various barriers and limitations. Firstly, social obstacle, the dissemination of secret or sensitive information relating to a company may be a social demand that is made upon an insider, with insider advice deemed a social requirement that undermines the market's trading regulations.

Another obstacle is how regulations relating to insider trading are interpreted by a court. There continues to be a lack of appreciation in Saudi Arabia that if no clear victim of unlawful activity can be identified, there should still be a case to answer for the illegal action. Consequently, jail sentences are often avoided by courts to punish wrongdoers, because of the perception that financial crimes typically do not produce victims. Furthermore, knowledge relating to financial crimes is often lacking among judges, which also proves to be an obstacle to enforcement. This is particularly relevant for crimes relating to finance as they are often victimless and,

accordingly, the judges are unwilling to enforce jail sentences. as well as that, a main restriction is that the judges, usually, are missing a general awareness and education on these crimes.

In conclusion, to answer the research question in terms of insider dealing, the capital market law and its regulations partly succeeds in protecting investor by banning insider dealing. However, there are some problems in enforcing insider dealing, as mentioned above.

Chapter 5: Market Manipulation

How well the the Saudi market conduct regulations defines market manipulation? To what extant the Saudi capital Market Law (2003) covers the most common forms of market manipulation? These questions were central to the discussion undertaken in Chapter Six. Thus, this chapter defined market manipulation, elucidates its common forms and examines the effectiveness of current laws in preventing these forms in comparison with similar UK regulations, whether these regulations will have helped the investor protection in Saudi stock market. The analysis suggests a need for further regulations to prevent market manipulating actions, which minimize the market efficiency, limit its growth and compromise its integrity. Manipulation could be prevented through a combination of improved transparency and availability of market information. These regulations should secure the market functions and enhance investor confidence and growth will be aided by the reduction of market manipulating.

As this chapter explore that, market manipulation concept generally does not have to involve trading; it can include establishment of ‘artificial’ or ‘false’ market prices. However, there has been disagreement between the courts and commentators in identification and description of the concept of market manipulation, which is led to the problem that lies to differentiate between what is legitimate speculation and what forms manipulation. Therefore, it is critical for regulators to maximum and stop market manipulation without prejudice and allow the natural growth of the stock market.

Market manipulation is an important matter for both the regulations of trading and the efficiency of the market. While this is a rising concern in several emerging stock markets. Moreover, this chapter has shown that integrity and fairness of the stock market is a necessary condition for the market’s expected role in supporting the real economy. By the same token,

rampant manipulation in the stock market leads to the opposite, as the must compensate for stock market losses.

As noted in this chapter, although there is no perfect definition of the term ‘market manipulation’, but there are some common practices that are considered to be manipulative since they contain commonly occurring elements. However, there are many forms and methods of manipulation, but they are all designed to achieve one purpose. This is to change the price of the securities for the benefit of the manipulator through fraud and misleading others. such as manipulation based on information, manipulation based on artificial transactions and price manipulation. The main types of stock market manipulation are pump and dump, churning, corners, pools, matched orders and sale wash.

Moreover, this chapter discovered that, the Internet is considered one the most important methods of manipulation. It is hard to oversee and control these Internet networks, as the Saudi market is based on such information. As stated, weaknesses exist in the current regulatory framework governing this area. Based on what has been explained previously, there is a regulatory gap in Saudi stock market that is facilitating the spread of manipulation schemes that are based on rumors. Since Saudi stock market regulations have no direct prohibition for such activates; unless a false statement of material fact instead, issuers are obligated to reply to any ongoing rumors that are affective the price of the issuer. This obligation is perfect in theory but it obliges very severe surveillance and enforcement capabilities in practice.

As a result of the conclusions drawn from this chapter, Manipulation should be defined ‘with respect to the intent, However, finding evidence of intent can be difficult. As a consequence of manipulation, a reduction in the burden of proof would result, making it easier to apply the law to wrongdoers, if a set of objective standards were set for demonstrating manipulative intent. Based on what has been a discussion in this chapter, it shows that try great similarity in the regulations of manipulation between the Saudi and the British regime, on this basis, there are behaviours that did not refer to Saudi a legislator, who could be considered to know the behaviour of manipulators.

From the results of this chapter, Article 49 in the Saudi capital Market Law (2003) and Articles II and III of conducts in the Saudi market law have not covered the most common forms of manipulation practices. Whether successful enforcement can be achieved, given the current

lack of legislation, is a crucial question. The degree to which investor are protected by the existing regulatory framework must be assessed, however the enforcement of any regulations is an essential prior question. Advanced markets have regulations that are already known to be sound, therefore they could easily be applied to the Saudi stock market. However, the understanding, introduction of and adherence to regulations in the legal field, by gatekeepers, citizens and watchdog bodies is potentially a considerable problem.

As yet, Saudi criminal law does not treat market manipulation as a serious criminal offence. Thus the implementation of securities legislation faces particular issues, while overall legislating of Saudi markets is problematic due to such perceptions. Minimal application of the existing laws with respect to market manipulation, as well as the lack of imposing criminal penalties applied within the legal system thus ensuring a low level of enforcement.

The Capital Market Authority has taken a number of steps in this direction, such as: organizing the work of broker and financial consulting and encouraging institutional investment through various investment funds, and project financial analysts body. It is expected that such measures will have a positive effect on the strategic directions of change in the balance of power in the market over time for the benefit of insider traders. The principle of ‘prevention is better than cure’ should be adopted in addressing the problem of the manipulation of the stock market. Carrying out a search on the reasons for the manipulation of stock market will allow this problem to be addressed at the root. Investor should be educated on methods of manipulation so that they can prevent themselves from falling into manipulators’ traps. Effective mechanisms and means should be developed to ensure the high transparency of trading and detect the different forms of manipulation.

In conclusion, to answer the research question in terms of Market Manipulation, the capital market law and its regulations partly succeeds in protecting investor. However, the regulations has not covered the most common forms of manipulation practices and does not define Market Manipulation properly.

Chapter 6: Market Broker

This chapter explored the responsibility that broker in the Saudi stock market have to achieve the greatest degree of protection for investor; under Authorized Persons regulations. Thus, the

following questions have been answered: ‘Are brokers a source of market manipulation?’ ‘Do broker owe fiduciary duty?’ ‘How does a broker provide suitable recommendations to his/her client?’ ‘What is the significance of suitability in stock market under its regulations?’ ‘What is the responsibility of brokers under Saudi Law?’. It was concluded that broker do indeed have a fiduciary responsibility to their clients. Saudi market law clearly sets out the seven requirements brokers must adhere to in order to comply with their fiduciary duty to their clients.

There are several objectives of this chapter. Providing greater assurances with regard to the stock market and stronger investor safeguards, assessing the foundation of all securities markets in the shape of brokers’ activities and associated legislation, as well as strengthening and improving Saudi capital Market Law (2003) and relevant regulations, were the major aims. The Saudi stock regulation’s implementation and enforcement of the most recent legislation should be assisted by this discussion, particularly with regard to the recent trends in legal action over poor broker advice.

As explained in this chapter, Saudi stock market regulations also make it apparent that a broker has this fiduciary obligation towards his or her clients. This being the case, if this commitment to the client is disregarded and contravened, the brokerage will have to suffer the consequences and pay the penalty –whatever that might be. Thus, the brokerage could be convicted of civil or criminal liability. For example, in Saudi Arabia it is a criminal offence to run a brokerage practice without being licensed, according to Saudi stock market regulations.

This chapter discovered that, it is important to consider that an entire country’s economy can be affected by manipulative practices, if a market ends up collapsing. In this regard, manipulation and taking advantage of one’s position as a financial broker is significant, as they often have many clients and enjoy a lack of regulative focus, thus greater efforts should be made to introduce more rules.

This chapter noted that, a broker has considerable accountability in relation to their clients, because the broker provides recommendations and guidance, thus acquiring their confidence. Thus a broker often engages in a cautious and careful assessment before providing proposals and advice, because legal liability is often a major concern of broker due to their accountability. It may be a difficult process to provide client-specific advice. In terms of the regulations that have been devised in relation to brokerage firms, there has been considerable progress, as

indicated by this study. Thus within the Saudi stock market and securities regulations, the regulations and issues that a broker must take into account before engaging in business are much clearer.

As indicated in this chapter Saudi regulations of stock market to an internationally accepted level, protection of client rights, risk-free nature of fiscal transactions and the guarantee of pacts between client and broker, can all be better ensured by introducing legal requirements. Furthermore, client-broker contractual agreements and the guarantee of certain broker rights are apparent within legislation. A broker will gain fiscal remuneration, in the form of commission, from involvement in interactions between a purchaser and a seller, within the regulations associated with the stock market.

As a result of the conclusions drawn from this chapter, Similar concepts exist concerning fiduciary obligations, with respect to each law. The application of rules section clearly states the fiduciary obligations in Saudi Arabia. The significance and consequences of this concept are clearly outlined to the broker and investor, due to the straightforward nature of the declaration. The wide array of applications across different fields have been outlined, with regard to each law's emphasis on suitability. Suitability was not a major concern when the Saudi capital Market Law (2003) was developed in 2003. However, the reassessment and amendment of regulations by the CMA began following the instances of securities fraud. The poor suitability of certain broker advice was decided in court cases; therefore, the regulations was adapted to incorporate issues of suitability. However, industry actors may be uncertain with regard to their obligations, because the degree to which successful prosecutions have rested on scienter liability has not been outlined in the regulations, apart from the CML recommendations.

Moreover, the Saudi stock market provides no previous instances through which to contrast a situation, because the Saudi Exchange has not published rules and principles in this regard. Consequently, a great deal of personal assessment is used in the formation of judgments. This research has proposed various solutions depending on varied environments, while also analyzing what investor in stock market are provided with in terms of company assurances. The operations of these companies and the regulations that govern them in Saudi have not been adequately investigated in the literature, reflecting the general lack of focus on developing securities markets.

As noted in chapter, Brokerage civil liabilities can be separated into: broker unlawful activity; broker negligence; damage and contributory dealings and relationships. In these cases, the burden of proof rests on the investor, who has to show evidence of wrongdoing, negligence and causal relationships. If the damage is proved, the investor is entitled to compensation in both civil and criminal liability cases. In conclusion, to answer the research question in terms of Market Brokers, the capital market law and Authorised Persons regulations partly succeeds in protecting investor.

7.3 Research Recommendations

- ❖ Despite its best efforts, the CMA has not been entirely successful in its aim of controlling mass speculation because of its inexperience and the high number of traders compared to the number of companies and existing shares. One possible approach to dealing with market manipulation is to take criminal proceedings against individuals found to engage in price manipulation. Rather than delaying and learning by trial-and-error, the CMA ought to learn from the regulations applicable in developed markets. For example, the issue of price manipulation in Saudi Arabia could be effectively addressed based on the British framework for control of market manipulation and insider dealing. Despite the monetary penalties it imposes on manipulators, the CMA actually stands to gain from such transgression because the penalties represent a financing source for it.
- ❖ An understanding of how investor think and of the market characteristics must be achieved prior to any proposals for disclosure regulations reform can be made. The past crash was to some extent caused by the fact that small investor did not have enough knowledge and experience. From 2004, the stock market of Saudi was transformed into a speculative market. Owners have direct control over most of the market funds (90%), but many of them are inexperienced in this task, as observed by Almubarak.⁸⁹⁴ This has resulted in market manipulation by large speculators, who used such tactics as false trading, rumour dissemination and incorrect news to successfully promote herding

⁸⁹⁴ Almubarak. (2005). Concern in the Saudi market due to "Alhoamir" Control. Available: http://www.aleqt.com/2005/11/16/article_16039.html. Last accessed 02th OCT 2016.

behaviour. Among the various available options is allowing institutional investor to become more actively involved, which may create greater uniformity, regulate market competition and promote better transparency. A greater volume of information available is another positive outcome of enhancing the involvement of institutional investor, which will make sure that actual knowledge, instead of rumour, will govern investor' activities.⁸⁹⁵

❖ Recommendations or analyst advice must be subjected to regulations and analysts must be specially certified and allowed to provide advice only based on having licenses issued by the CMA. In this way, the CMA will be able to regulate the activity of analysts, which will be considered as violating the law in the absence of appropriate licensing. Such a strategy would have several benefits, including prevention of manipulative activity, insider trading, guarantee of the relevance of suggestions about securities in Saudi, and an emphasis on the fact that the duty of suggestion or advice provision is due care rather than due diligence.

❖ The CMA should give the collected monetary penalties to the investor who have been directly affected by the transgression, while the individuals found guilty of price manipulation should be given a prison sentence. Although Islamic Law forbids market manipulation as a prejudice, no punishment is specified; similarly, insider dealing is prohibited as “cheating” and is considered to be a crime. The general principles of Islamic Law that forbid all activities that are harmful to others are respected by the CML. Indeed, it outlawed market manipulation. Since it is based on general principles of market operation, Islamic Law usually displays a high degree of flexibility and malleability. However, changes have to be made to practice to take into account the transformations in finance and trade.

❖ Making sure that small investor are protected should be a priority for Saudi regulators. Other matters that require their immediate attention is the monopoly held by foreign institutional investor over global securities markets. The activity of these investor requires regulations and the protection of the overall financial system must be guaranteed, particularly as their entrance to the SSE Began 15/6/2015.

❖ The wording of the financial statements must be clear to investor, especially as they may not be familiar with some technical terms. Investor may change their mind

⁸⁹⁵ IMF Report (2005). Available: <http://www.alriyadh.com/130876>. Last accessed 12th Jan 2016.

about investing in a company if they are confused by that company's financial information. Ethical considerations and accounting principles and technicalities are often emphasized by companies during preparation of financial statements at the expense of the intended readers. The level of influence that published financial reports have over investors' decisions can be said to depend on the degree to which those reports are understood by the investor.

❖ It is proposed that a ten-day rather than fifteen-day limit for releasing preliminary financial reports should be stipulated by the CMA, based on the overall findings of this research. Publication of information would then be at less risk from being leaked prematurely, while generally being a more reasonable timeframe in which to release financial information.

❖ There are few studies that have focused on Saudi Arabia and preliminary financial reports, reflecting the small number in general that focus on Arab countries. It is strongly recommended to pay great attention to this matter and conduct more studies in order to improve stock market regulations.

❖ Inside information tends to be exploited due to its confidentiality. Public dissemination of such information can prevent the temptation to exploit its use.

❖ The integrity and reputation of markets, their growth and efficiency are all hindered by manipulation of markets, therefore more regulations is advocated on the basis of this research. Making market information more accessible, as well as enhancing openness, can both diminish the extent of manipulation. Family investments and savings, efficiency of the markets and overall investor assuredness would be improved through the protection of markets via regulations.

❖ Shares are often easier to interfere with when belonging to small companies, therefore they are usually the focus of manipulation. Consequently, these companies should be focused on in terms of regulations. It is important to put in place measures to curb illegal speculation, while taking parallel action to encourage beneficial speculation carried out by insiders.

❖ During the tackling of stock markets' manipulation, it will be easier to deter such activities than respond to them once they have occurred. Resolving the issues at their foundation will be possible by carrying out further studies into the causes of manipulation. Perpetrators likely methods should be identified and explained to investor, so they can avoid being embroiled in manipulative activity. Effective

mechanisms and means should be developed to ensure the high transparency of trading and detect the different forms of manipulation.

❖ In order to enhance the Capital Market Authority's regulatory and enforcement capabilities, rather than dispersed mentions of brokerage role there should be clear responsibility and powers given to the Authority in a specific section detailing authorized person. When detrimental financial consequences occur from brokerage companies' illegal behaviour, there should be a strong adherence to legal procedures for investigating and prosecuting such activities. Moreover, Existing stock market law largely focuses on protecting investor rights, however there should be more guidelines and rulings with regard to the buying and selling of securities in relation to the brokerage companies to fulfil their rights.

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