International Standards and the Administrative Model of Capital Market Regulation in Kuwait

Dr. Asim Jusic, Asst. Prof.
Kuwait International Law School

Dr. Farah Yaseen, Asst. Prof.
Kuwait International Law School

Abstract:

In light of international standards for the governance of capital markets set by the International Organization of Securities Commissions (IOSCO) and related international accounting and auditing standards, we evaluate the Kuwait Capital Markets Authority Law (CMA Law) and the institutional position, capabilities and regulatory powers of the Capital Market Authority (CMA) and capital markets courts. Our analysis shows that, overall, the CMA Law is largely compliant with the selected IOSCO standards.

However, the institutional positioning and functioning of the CMA is susceptible to multiple challenges and sources of systemic risk, brought about by informational asymmetries, moral hazard, and adverse selection. These risks and challenges have not only to do with the CMA Law itself, but also with the very nature of capital markets, and weaknesses inherited from the pre-2010 period. Among these, we single out the following 'top-down' and 'bottom-up' risks and challenges. Firstly, the position of the CMA as an administrative regulator with formally high independence comes at a cost of limited accountability, which is potentially a source of systemic risk. Secondly, the consistency, clarity, and timeliness of the CMA's rule-enforcing and supervisory decisions, and their review by capital markets courts, are suboptimal and require a bottom-up strengthening. Finally, within the Kuwait capital market, consistent application of international accounting and, to a somewhat lesser extent, auditing standards is still lax, and in need of capital-market-wide regulation.

Introduction

As a part of the structural changes to its legal and economic infrastructure, reform of the capital market in Kuwait has been an ongoing process since the enactment of the first comprehensive 2010 Capital Market Authority Law, later amended in 2014 and again in 2015 (hereinafter the CMA Law)[1]. The CMA Law grants the power to regulate the capital market to an independent administrative authority, the Capital Market Authority (hereinafter the CMA), and aims to increase transparency, fair market competition and the prevention and control of systemic market risk. In effect, this implies the application of the CMA Law is supposed to align with the internationally accepted standards for regulation of capital markets promoted by the International Organization of Securities Commissions (IOSCO), alongside the international accounting and auditing standards endorsed by IOSCO[2].

(1) Law No. 22 of 2015 Amending Some Provisions of Law No. 7 of 2010 regarding the Establishment of the Capital Markets Authority and Regulating Securities Activities.

(2) For an overview of the history and relevance of IOSCO and IFRS standards for international capital market regulation, see Eilís Ferran and Look Chan Ho, Principles of Corporate Finance Law (Oxford University Press 2014) 423–427. Assessment of Kuwait capital market regulation in light of IOSCO principles before the enactment of the CMA Law in 2010 can be found in Amani Bouresli, 'A Study of the Regulatory & Organizational Structure of the Capital Market of Kuwait in the Light of the IOSCO Principles & the World Bank Report' (2009) 35 The Journal of the Gulf and Arab Peninsula Studies. the regulations governing it do not stand for its size and value.
The market is functioning under a decree that was drafted in 1983 as a reaction to Al Manakh stock market crisis. In this study, we examine the extent to which the securities market complies with the international best practices and the IOSCO objectives. An intensive diagnostic analysis is performed, in the light of the field study and the World Bank FASP report, to explore all major shortages and deficiencies associated with the regulatory and organizational structure of the securities market. The investigation revealed that the securities market infrastructure does not comply with the international best practices issued by the IOSCO organization.
The results show that Kuwait was not able to achieve a fully implemented or broadly implemented score in any of the 30 assessors examined in both the analysis performed in this study or in the World Bank Report performed four years ago which confirms the fact that the securities market is poorly regulated and suffers from serious weaknesses. Further more, the study lists the requirements needed to achieve a fully implemented score. Finally, a list of recommendations was provided for each shortcoming addressed=

Our goal in this paper is to analyze the CMA’s institutional position, and the regulatory processes it controls, using the IOSCO standards as benchmarks. In Part I of the paper, we discuss the IOSCO principles and the standards and guidelines related to the regulator and the international accounting and auditing standard-setters for transparency, disclosure, and financial reporting, which serve as our benchmark for evaluation of the CMA Law. As we show throughout our discussion, the CMA Law forms a highly systematic framework for securities regulation, largely compliant with the IOSCO standards for regulatory objectives and the position of the regulator, transparency, and disclosure.

Yet many challenges remain, largely due to the fact that the capital market in Kuwait, as elsewhere, is susceptible to sources of systemic risk brought about by informational asymmetries, moral hazard, and adverse selection(1). These are partially caused by the CMA’s institutional position, but also by the remnants of the pre-2010 capital market regulation (discussed in Part II), and the nature of capital markets, which require heavy investment in

=in a manner consistent with the market structure and legal environment. As a priority the government should take steps to pass a new comprehensive securities law that establishes a new regulatory independent authority.”,”author”:[{“family”:”Bouresli”,”given”:”Amani”}],”issued”:{“date-parts”:[[“2009”]]}}}],”schema”:”https://github.com/citation-style-language/schema/raw/master/csl-citation.json”}

(1) Information asymmetry arises when one party in a relationship or transaction has more or better quality information than the other, see George A Akerlof, ‘The Market for “Lemons”: Quality Uncertainty and the Market Mechanism’ (1970) 84 Quarterly Journal of Economics 488. Moral hazard and adverse selection are both examples and results of information assymetry, see text and accompanying footnotes in Part III.1.1 infra. IOSCO specifically includes information assymetry and moral hazard among sources of systemic risk, see IOSCO, ‘Mitigating Systemic Risk: A Role for Securities Regulator’ 21
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD347.pdf> accessed 28 March 2016.

legal infrastructure as a precondition for success[1]. These challenges and our response to them are presented in the following, in order of importance.

As we show in Part III of the paper, the positioning of the CMA as an administrative regulator with limited governmental supervision is potentially a source of systemic risk, since, as things currently stand, the CMA scores highly on scales of independence, but falls short on scales of accountability for its overall policy. This is due to the CMA’s position as the ‘administrative branch’ within a Kuwait constitutional system that, due to an incremental increase in a number of administrative bodies, can be said to be partially evolving toward a system of ‘constrained parliamentarianism’.2 As a solution by which the first-level policy accountability of the CMA as regulator can be improved, we propose establishing a direct ‘joint and several’ ex-post responsibility of the Chairman of the Board of Commissioners of the CMA alongside the responsible minister in front of the National Assembly.

Furthermore, consistency, clarity, and timeliness of the CMA’s rule-enforcement and supervisory decisions, and the review of these in capital markets courts, presently appear sub-optimal. They need to be aligned not only with the letter of the CMA Law, but also its goals. Improvements of the CMA’s and capital markets courts’ human resources are also required to facilitate this.

As the evidence presented in Part IV proves, application of international accounting and auditing standards by participants in capital market is lax, and the CMA should make it wider and more effective if market transparency is to be increased, and the systemic risk of repeating the 1982 stock market crash is to be reduced. Drawing on examples of the standardization of accounting and auditing in the banking industry supervised by

(1) Bernard S Black, ‘The Legal and Institutional Preconditions for Strong Securities Markets’ (2001) 48 UCLA Law Review 781.
(2) Bruce Ackerman, ‘The New Separation of Powers’ (2000) 113 Harvard Law Review 633.

the Central Bank of Kuwait, and the French and American examples of the capital-market-wide regulation of accounting and auditing, we discuss the advantages and disadvantages of two models of regulation of accounting and auditing standards. We recommend the establishment of a separate, country-wide independent authority(ies) for accounting and auditing in the capital market as likely the only sustainable solution in the long run.

I. International Standards for Capital Markets Regulation

I.1. The Nature of International Financial Standards

The CMA Law and by-laws state on many occasions that regulation of the capital market should adhere to the highest international standards and principles, albeit without specifying these[(1)]. However, the Chairman of the CMA states the goal of the CMA Law and the CMA as a regulator is to elevate the capital market in Kuwait to the level of an emerging market, and place the CMA in the ranks of membership of IOSCO[(2)]. Hence, standards referred to by the CMA Law are mostly those directly developed by IOSCO, or, as is the case with International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA), those endorsed by IOSCO and developed by other international standard-setters; the International Accounting Standards Board (IASB), and International Federation of Accountants (IFAC)[(3)].

(1) See Resolution No. (72) of 2015 of November 9th, 2015 – on Issuing the Executive bylaws of the Law No. (7) of 2010 Regarding the Establishment of Capital Markets Authority and Regulating Securities Activities and its Amendments in Kuwait, and Executive Bylaws of the Capital Markets Authority Law No.7 of 2010, book 5, Art. 2(1), Art. 4(4)(3), Art. 7(4)(3), and Annex (2); book 15, ch. 3, Art. 2(5) and Art. 10(3), and ch. 8, rule n.7, Art. 5(8).

(2) Capital Markets Authority, 'Capital Markets Authority - Chairman's Message' https://www.cma.gov.kw/En_Chairman_Message.cms> accessed 16 April 2016.

(3) This is by no means a full list. The IOSCO principles and standards are also closely intertwined with the Organization for Economic Cooperation and Development's OECD Principles of Corporate Governance, and are regularly used by the World Bank and International Monetary Fund in the Financial Sector Assessment Program, see IOSCO, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (August 2013) 11–12 <http://www.iosco.org/> accessed 28 March 2016.

These international standards are soft law that can be described as a form of non-binding 'encouragement' for states[1]. Critics find this view of soft law controversial and unconvincing, as it does not differentiate between soft laws and other types of obligations, fomenting an over-broadness that would include anything that is 'law-like' under its umbrella[2]. We do not attempt here, however, to engage the largely theoretical debate on the authority of soft law in international public law, as this debate is of no practical consequence: if the states and private actors voluntarily accept and adhere to international standards of capital markets and financial regulation, how could it matter whether the standards are binding or not?

The pragmatic answer might be that whether or not standards are binding is irrelevant in good times, since parties have stakes in adopting them, but it is relevant in bad times, when the inter-connectedness of international capital and financial markets spreads systemic risks and produces a global financial crisis. A formalistic answer might be that international capital markets and financial reporting and auditing standards form a part of the global administrative network for international financial regulation that largely consist of market regulators and government representatives[3]. By virtue of the nature and public authority of network members, otherwise formally non-binding soft international standards are incorporated or translated into 'hard' national (quasi-)public law instruments[4].

(1) Andrew T Guzman and Timothy L Meyer, 'International Soft Law' (2010) 2 Journal of Legal Analysis 171, 172.

(2) Timothy Meyer, 'Soft Law as Delegation' (2008) 32 Fordham International Law Journal 888, 890.

(3) David Zaring, 'Informal Procedure, Hard and Soft, in International Administration' (2005) 5 Chicago Journal of International Law 551. On global administrative networks for financial regulation and IOSCO in particular, see Stavros Gadinis, 'Three Pathways to Global Standards: Private, Regulator, and Ministry Networks' (2015) 109 American Journal of International Law 1, 25-28.

(4) Antonio Marcacci, 'IOSCO: The World Standard Setter for Globalized Financial Markets' (2012) 12 Richmond Journal of Global Law and Business 23, 36.\\uc0\\u8216{}IOSCO: The World Standard Setter for Globalized Financial Markets\\uc0\\u8217{} (2012

I.2. International Organization of Securities Commissions (IOSCO) Standards for Capital Market Regulators

IOSCO was established in 1974 as an inter-American regional association of securities regulators. In 1983, it transformed itself into an international body that today consists of securities commissions and top-level financial regulators from more than 100 countries that regulate more than 90% of the world's securities markets[1]. As IOSCO has not been established by treaty, strictly speaking it cannot be considered an international organization but a private standard-setting body, albeit one whose members are mostly public authorities, capital market authorities and financial regulators. Due to its membership and evolving normative role resulting from a demand for a unification of standards for the regulation of capital markets worldwide, IOSCO's principles and standards have become quasi-public national law instruments mostly through explicit incorporation or simple recognition[2] .

In September 1998, IOSCO published objectives and thirty principles of securities regulations, and in 2010, responding to the financial crisis, amended its objectives and included eight additional principles. Post-2010, the three IOSCO objectives of securities regulation remain, as in 1998, protection of investors, ensuring market transparency and fair efficiency, and reducing systemic risk. To achieve these objectives, the expanded thirty-eight principles are more detailed and grouped into nine categories: principles relating to the regulator (1-8); principles for self-regulation (9); principles for the enforcement of securities regulation (10-12); principles for cooperation in regulation (13-

(1) Roberta S Karmel, 'IOSCO's Response to the Financial Crisis' (2012) 37 Iowa Journal of

Corporation Law 849.

(2) Marcacci (n 12) 23,36.36.»,»plainCitation»:»Marcacci (n 12

الدكتور محمد احمد محمود عمارنة، رقابة هيئة سوق رأس المال على الشركات المساهمة، المركز القومي للاصدارات القانونية، القاهرة 2014، ص.250-257. (Mohamad Ahmad Mahmoud Amarna, Capital Markets Authority Supervision of Joint Stock Companies, National Center for Legal Studies, Cairo 2014, 250-257).

15); principles for issuers (16-18); principles for auditors, credit rating agencies, and other information providers (19-23); principles for collective investment schemes (24-28); principles for market intermediaries (29-32); and principles for the secondary market (33-38)[1].

All principles are broadly worded and generic in nature, as they are meant to serve as a global framework in capital markets with vastly different legal and economic structures. In order to avoid misinterpretation or ineffective implementation of its principles due to differences between jurisdictions in which regulators operate, the IOSCO methodology for assessing the implementation of objectives and principles recognizes that the assessment of compliance with principles should be cognizant of the institutional differences between countries[2].

Here, we do not aim to analyze all IOSCO principles in detail. Rather, we draw attention to how various principles affect regulatory goals and the position of the regulator.

Overall, as capital markets regulators are mostly governmental bodies with public authority, IOSCO principles require that regulators' authority and capabilities should be real and not compromised through direct or indirect limitations of actions or independence. Regulators, according to Principles 1-3, should be endowed with qualities of independence, accountability, and powers necessary and well enough defined to achieve regulatory goals. The power to regulate, enforce, and supervise the market is not supposed to be merely formal, but effective and backed by credible resources for the regulator to exercise its powers. These requirements have an overarching impact on

(1) IOSCO, 'Objectives and Principles of Securities Regulation' (June 2010) <http://www.iosco.org/library/pubdocs/pdflIOSCOPD323.pdf> accessed 28 March 2016.

(2) IOSCO, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (n 8) 20–21.

other principles, i.e. the third category of principles (Principles 10-12) requires regulators to have sufficient power to enforce securities regulations(1).

Beyond the capability and independence requirements, IOSCO principles also require that the regulator itself acts in a transparent and professional manner. IOSCO Principle 4 determines that, in the process of regulation, the regulators actions should be clear, understandable and consistent, based on publicly disclosed policies implemented in a fair and transparent way(2).Transparency, according to IOSCO Principle 5, implies that the regulator's employees and staff should act in a highly professional and confidential way. Taken together, the two standards are about reducing under-detected connections between markets and institutions, as regulators should avoid, eliminate, disclose, or manage any conflict of interest and misalignment of incentives.

One of the most significant changes in the post-2010 IOSCO principles pertaining to the regulator is that no less than three new principles (Principles 6-8) are devoted to the reduction of systemic risk(3). This was a result of the impact of the 2008 financial crisis on capital markets, yet the introduction of these principles left some uncertainties as to the exact meaning of systemic risk, and principles' implications for and requirements placed upon capital market regulators(4). In the period from 2011 to 2013, IOSCO revised its understanding of systemic risk and defined it as the potential of an event or a chain of events to have a widespread adverse effect on the financial system and

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(1) IOSCO, 'Objectives and Principles of Securities Regulation' (n 15), Principles 1-12.

(2) IOSCO, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (n 8) 33.

(3) IOSCO, 'Objectives and Principles of Securities Regulation' (n 15), Principles 6 – 8. The second most important change relevant for this paper is a detailed treatment of principles for auditors, see Part I.3 infra.

(4) Karmel (n 13) 849–853.

the wider economy. Events include not only catastrophic events, but also the more gradual erosion of market trust[1].

Capital market regulators are not expected to eliminate systemic risk in full (that would mean that the market no longer exists), but to reduce its causes. They might not have a full mandate to do so, and limitations of a regulator's institutional position and mandate is a source of systemic risk in itself, albeit one that is not frequently discussed[2].

I.3. Transparency and Disclosure: IOSCO Endorsed Disclosure, Accounting and Auditing Standards

Disclosure is a key method for ensuring transparency and protecting the functioning of the market. It can be defined as the sharing of information, documents and reports, which allows current and potential investors to take appropriate investment decisions[3]. Its main goal is securing market transparency so that investors have the ability to assess investment risks. In order for all market participants to understand the disclosed information in the same way, disclosure requires some degree of standardization regarding the form used for communicating the information. Accounting and auditing standards are supposed to be that 'common language', used for purposes of creation and control

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(1) IOSCO, 'Mitigating Systemic Risk: A Role for Securities Regulator' (n 3) 13.

(2) Steven L Schwarcz, 'Controlling Financial Chaos: The Power and Limits of Law' (2012) 3 Wisconsin Law Review 815, 827 n48.

(3) دكتور احمد عبدالسلام، الشفافية والافصاح في سوق الأوراق المالية، دار النهضة العربية، القاهرة 2013، ص.50-44 (Ahmad Abdessalam, Transparency and disclosure in the securities markets, Dar Al-Nahda AlArabia, Cairo 2013, 44-50); دكتور احمد البار، الالتزام بالشفافية والافصاح عن المعلومات في بورصة الوراق المالية، دار الجامعة الجديدة الاسكندرية 2015، ص. 102-106 (Ahmad AlBar, Commitment to Transparency and Disclosure of Information in the Stock Market, Dar AlJamia Al-Jadida, Alexandria 2015, 102-106); لدكتورة مروة محمد العيسوي، مدى توافق البورصة مع مبدأ السرية، المركز القومي للدراسات القانونية، القاهرة 2016، ص.21-17؛ (Marwa Mohamad AlIsawi, Conformity of the Stock Exchange with the Principle of Confidentiality, National Center for Legal Studies, Cairo 2016, 17-21). See also Marcacci (n 12) 38»plainCitation»:»Marcacci (n 12, and Eleonora Zlotnikova, 'IOSCO's Information Disclosure Proposals and the Potential for Regulatory Arbitrage' (2010) 35 Brooklyn Journal of International Law 965.

of financial statements, so that disclosure is full, accurate and timely, covering all financial results, risks and other information relevant to investors' decisions[1].

IOSCO principles only refer to international accounting and auditing standards of the highest quality, without providing further details[2]. In terms of accounting standards, IOSCO has endorsed the international accounting standards developed by the International Accounting Standards Board (IASB)[3], which now acts as the standard-setting body for the development of International Financial Reporting Standards (IFRS). The IFRS, currently mandated for use by more than 100 countries, including the European Union and more than two-thirds of the G20, aims to be the global accounting standard, providing users of financial statements "with the ability to compare the financial performance of publicly listed companies on a like-for-like basis with their international peers"[4].

Compared to most (now slowly waning) national accounting standards, many consider the IFRS to be transparency-oriented standards, due to their heavy disclosure demands[5]. The logic

(1) IOSCO, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (n 8) 92–93.

(2) IOSCO, 'Objectives and Principles of Securities Regulation' (n 15), Principles 18 and 21.

(3) 'IFRS - IOSCO and IFRS Foundation Agree Joint Protocols to Enhance Consistency in the Implementation of IFRS Globally' <http://www.ifrs.org/Alerts/PressRelease/Pages/IOSCO-and-IFRS-Foundation-agree-joint-protocols-September-2013.aspx> accessed 31 March 2016.

(4) 'IFRS - What Are IFRS?' <http://www.ifrs.org/about-us/pages/what-are-ifrs.aspx> accessed 31 March 2016.

5 See Bernard Raffournier, 'The Application of IFRS Across Different Institutional Environments' in Carien van Mourik and Peter Walton (eds), The Routledge Companion to Accounting, Reporting and Regulation (Routledge 2014) 286–289, and IFRS (incorporating IAS) standards on disclosure IFRS 7 (financial instruments: disclosures), IFRS 12 (disclosure of interests in other entities), IAS 1 (presentation of financial statements), IAS 20 (accounting for government grants and disclosure of government assistance) and IAS 24 (related party disclosure) at 'IFRS - Access the Unaccompanied Standards'
<http://www.ifrs.org/IFRSs/Pages/IFRS.aspx> accessed 31 March 2016.

behind them is increasing investors' trust and decreasing risks by providing the information necessary for investment decisions in real time, a reason for which the IFRS is considered the most favorable set of accounting standards for opening or 'emerging' capital markets[1]. To achieve this, the regulation of the application of the IFRS within national boundaries should prescribe at least the minimal level of disclosure of qualitative and quantitative information that the entity must provide so that end-users of financial statements can reliably assess an entity's financial position and performance, in particular its risk exposure[2]. Because these minimal levels are easy to prescribe but hard to enforce, the consistent application of the IFRS requires heavy investment in legal preconditions for securing consistent disclosure.

Given the saliency of the pre- and post-2008 financial scandals involving large auditing firms, during the process of expansion of its original thirty principles, in 2010 IOSCO was keen to strengthen principles related to the independence and oversight of auditors and the use of audit standards of a high and internationally acceptable quality[3]. For IOSCO, 'high quality' means the international standards on auditing (ISA) developed chiefly by the International Auditing and Assurance Standards Board (IAASB), the independent standard-setting body of the International Federation of Accountants (IFAC)[4].

Like their accounting IFRS counterparts, the ISA standards also include extensive disclosure requirements[5]. The applica-

(1) Raffournier (n 28) 282, 286.

(2) See IFRS 7 (financial instruments: disclosures).

(3) IOSCO, 'Objectives and Principles of Securities Regulation' (n 15), Principles 19-21.

(4) Kathryn Cearns, 'Auditors and International Financial Reporting' in Carien van Mourik and Peter Walton (eds), The Routledge Companion to Accounting, Reporting and Regulation (Routledge 2014) 392.

(5) See IOSCO, 'IOSCO Statement on International Auditing Standards' <https://www.iosco.org/library/statements/pdf/statements-7.pdf> accessed 31 March 2016, and 'International Standards on Auditing (ISAs) |IAASB | IFAC' <https://www.ifac.org/auditing-assurance/clarity-center/clarified-standards> accessed 31 March 2016.»plainCitation»:»'International Standards on Auditing (ISAs

tion of the ISA-level audit with extensive disclosure is meant as a 'second-level control' that ensures that the financial reports of entities are assessed for any potentially fraudulent misstatements. Ultimately, the goal is to detect and prevent the risk of abuse of ambiguous statements in a management's financial reports, which might obscure a proper understanding of the matters disclosed, for example changes in internal and external factors and the management's supervision of employees. However, the reliability of audit reports is directly dependent on the consistent use of underlying accounting standards, as the information in financial statements is the material upon which the audit is performed[1]. Without a consistent application of the accounting standards (i.e. the IFRS), a high quality audit is not entirely possible, since assumptions about how the process of producing financial statements is to be done are not shared by the auditors and accountants.

Overall, since the accounting and auditing standards and standard-setting bodies that produce them are interconnected with IOSCO, either institutionally or as a matter of endorsement and cooperation, the IFRS and the ISA standards comprise a single integrated framework with the IOSCO principles.

II. Regulation of the Capital Market in Kuwait prior to the CMA Law

Trading in shares in Kuwait bases most of its origins in the founding of the National Bank of Kuwait, one of the first shareholding companies in Kuwait, in 1952. In the decades that followed, various regulations directly or indirectly affecting over-the-counter share trading were enacted, in particular the Law of Commercial Companies No. 15/1960, which can be seen as the cornerstone of the regulation of commercial affairs in

(1) Cearns (n 32) 392.

the country. In response to the Kuwaiti stock market crash of 1982, in August 1983, the first formal stock exchange, the Kuwait Stock Exchange (KSE), was established[1].

The KSE was structured as independent financial institution managed by the Market Committee (MC), which consisted of the Minister of Commerce and Industry as its president, and representatives of the Ministry of Finance, Central Bank of Kuwait (CBK) and the Kuwait Chamber of Commerce and Industry. Effectively, the KSE had a diversified model of governance, with the MC controlling the process of market incorporation for companies, and the CBK supervising and licensing the operation of financial institutions within the KSE[2].

In the years following its establishment, the KSE functioned with some degree of success, in spite of obstacles related to the wider legal framework and the institutional structure of the capital market regulation and oversight, which made both lax disclosure and widespread insider trading possible. Throughout the period from 1983 to 2010, the Law of Commercial Companies No. 15/1960 was criticized for lacking sufficient standards of corporate governance and adequate sanctions for insider trading.3 Disclosure rules, which, as of 1999, were regulated by the Disclosure of Interest in Shares Law No. 2/1999 and KSE regula-

(1) See Mishari M Alfraih and Faisal S Alanezi, 'The Value Relevance of Mandatory Corporate
Disclosures: Evidence from Kuwait' (2015) 9 International Journal of Business and Finance Research 1, 3the level of compliance with mandatory IFRS disclosures of Kuwait Stock Exchange (KSE; and Mishari Alfaraih, 'Compliance with International Financial Reporting Standards (IFRS) and the Value Relevance of Accounting Information in Emerging Stock Markets: Evidence from Kuwait' (PhD thesis, on file with the author, Queensland University of Technology 2009) 15–26.

(2) Alfaraih (n 35) 27.

3 ibid.

tions, were very weak in terms of regulating periodic, real time and affirmative disclosures[1].

The 2004 International Monetary Fund Financial Sector Assessment evaluated the compliance of the Kuwait capital market regulations with the IOSCO objectives and principles and found that many IOSCO principles were not implemented, particularly those pertaining to the capital market regulator itself (Principles 1 to 5). According to the IMF, several authorities with unclear and overlapping powers regulated the securities market, all of them lacking the operational independence, accountability, and human and material resources necessary for the exercise of their functions and powers, the result being inconsistency and a lack of clarity of the process of securities market regulation[2].

The later 2009 World Bank Report confirmed the earlier IMF findings, which motivated Kuwaiti scholars to call for the reform of the regulation of the capital market, arguing that authorities

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(1) Fahad Al-Zumai, 'Comparative Study of the Legal Framework of Securities Disclosure Requirements in Kuwait and the U.S.' (2007) 21 Arab Law Quarterly 230.<i>inter alia</i>, the disclosure of interest; periodic and real time disclosures; and rumours and duties to disclose in both jurisdictions. Afterward, anti-fraud provisions and their role in enhancing the disclosure framework are discussed and the investigation concludes that the absence of an anti-fraud provision in securities regulation in Kuwait is undermining the efficiency of the regulatory framework of disclosure in the country. Finally, the paper concludes that regulatory reform is needed in Kuwait to fill in the gaps in the current structure and in particular the current available remedies. The scope of disclosure should also be expanded to capture all major sensitive information that needs to be disclosed to the public and the shareholders.»,»DOI»:»10.1163/026805507X226782»,»ISSN»:»1573-0255»,»author»:[{«family»:»Al-Zumai»,»given»:»Fahad»}],»issued»:{«date-parts»:[[«2007»,9,1]]}}}],»schema»:»https://github.com/citation-style-language/schema/raw/master/csl-citation.json»}

(2) International Monetary Fund, 'Kuwait: Financial Sector Assessment Program--Detailed

Assessments of Observance of Standards and Codes--International Organization of Securities Commission (IOSCO)--Objectives and Principles of Securities Regulation' (2004) 15–19 <https://www.imf.org/external/pubs/ft/scr/2004/cr04352.pdf> accessed 7 March 2016.

should align it with the IOSCO standards[1]. This shows that three issues prevented a stronger growth of the capital market in Kuwait in the pre-2010 period. Firstly, there was a lack of clear institutional structure for capital market regulation regulated by an operationally independent and accountable regulator. Secondly, there was inconsistency and uncertainty of regulation, alongside limitations of regulators' human and material resources. Finally, there was an underlying lack of consistent application of internationally comparable accounting and auditing standards, which was likely also the cause of the 1982 crash of the Kuwait Stock Market.

III. The CMA's Institutional Positioning and Regulatory Process

III.1. Institutional Position of the CMA between Independence and Accountability

Formally speaking, in terms of its institutional nature and position within the Kuwaiti legal system, the legislator, through the CMA Law, is structured the CMA as an autonomous independent

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(1) Bouresli (n 2).the regulations governing it do not stand for its size and value. The market is functioning under a decree that was drafted in 1983 as a reaction to Al Manakh stock market crisis. In this study, we examine the extent to which the securities market complies with the international best practices and the IOSCO objectives. An intensive diagnostic analysis is performed, in the light of the field study and the World Bank FASP report, to explore all major shortages and deficiencies associated with the regulatory and organizational structure of the securities market. The investigation revealed that the securities market infrastructure does not comply with the international best practices issued by the IOSCO organization. The results show that Kuwait was not able to achieve a fully implemented or broadly implemented score in any of the 30 assessors examined in both the analysis performed in this study or in the World Bank Report performed four years ago which confirms the fact that the securities market is poorly regulated and suffers from serious weaknesses. Further more, the study lists the requirements needed to achieve a fully implemented score. Finally, a list of recommendations was provided for each shortcoming addressed in a manner consistent with the market structure and legal environment. As a priority the government should take steps to pass a new comprehensive securities law that establishes a new regulatory independent authority.»,»author»:[{«family»:»Bouresli» ,»given»:»Amani»}],»issued»:{«date-parts»:[[«2009»]]}}}],»schema»:»https://github.com/citation-style-language/schema/raw/master/csl-citation.json»}

administrative agency, supervised by the government in a limited way, with an unusually high level of self-governance, rule-production powers, external and internal financial independence, freedom to make staffing decisions and represent itself.1 The authority of the Chairman of the Board of Commissioners, the governing body of the CMA, to make financial and budgetary decisions is equated to that of the Minister of Finance, insulating the CMA, at least to a certain extent, from financial pressures.

Care has been taken to increase the transparency of the work of the CMA as a regulator by imposing on it an obligation to submit annual reports on its work to the Minister of Commerce and Industry(2). The Commissioners and employees of the CMA are subject to detailed disclosure requirements and limitations of personal involvement with the market by the law and codes of ethics, with an aim of preventing them from abusing their position within the regulator and improving their overall efficiency and professionalism(3).

When measured against IOSCO principles pertaining to the regulatory goals and the position of the regulator, the CMA Law appears formally highly compliant. It secures the CMA's transparency, defines responsibilities, and bestows it with adequate powers and resources to fulfill its role as a securities regulator. The CMA's capabilities are aligned with the goals of the CMA Law – fairness, transparency, efficiency and the reduction of systemic risk in the capital market – which are almost verbatim

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(1) See Art.2 (establishment of authority), Art.6-8 (Board of Commissioners and independent representation), and Art.16-23 (internal governance, staffing and legal representation, independent budget and budgetary decisions, exemptions from governmental audit and public tendering regulations) of the CMA Law.

(2) Art. 25 of the CMA Law .

(3) See Art. 4(9) and Art.26-29 of the CMA Law and 'Capital Markets Authority - Charter of Code of Ethics for CMA Commissioners and Employees' https://www.cma.gov.kw/En_charter_of_Code_of_ethics_for_cma_commissioners_and_staff_members.cms> accessed 31 March 2016.

identical to IOSCO's objective for the regulation of the securities market[1].

However, as we show below, the borders between administrative independence and government supervision are blurred, and, in addition, the accountability of the CMA as a regulator appears only very partial. Each of these, in its own way, is a distinct source of systemic risk.

III.1.1 Constrained Parliamentarianism and the CMA as a 'Government-Led' Administrative Regulator with Limited Accountability

Overall, the formal independence of the CMA as a regulator is high, but this formal independence does not necessarily translate into de facto independence. The constitutional foundation of the CMA's independence and autonomy is Article 133 of the Kuwaiti Constitution, which grants the National Assembly the right to regulate public bodies in such a way as to ensure their independence under the direction and supervision of the government.2 The formal independence is better described as ex-post independence, as is visible in the process of appointments to the CMA's governing body, the Board of Commissioners. The Minister of Commerce and Industry proposes candidates for the Board of Commissioners without the authority to oversee their post-appointment mandate or intervene into the Board of Commissioners' decision-making processes and staffing policy.

De facto, however, as recent empirical studies have shown, the independence granted to the CMA by the legislature cohabits uneasily with the executive power, as the exact limits between administrative independence and governmental direction and supervision are far from clear, continuously swinging in different directions, frequently favoring governmental direction over

(1) cf. Art. 3.(1), (4) and (5) of the CMA Law with IOSCO, 'Objectives and Principles of Securities Regulation' (n 15) 3.

(2) Art. 133 of the Constitution of Kuwait.

administrative independence[1]. For that reason, with qualifications we discuss in Part III.3 below, we categorize the CMA as the ‘government-led’ administrative regulator, roughly similar to capital market regulators in countries with French and Germanic civil law traditions[2].

This precarious and easily disturbed administrative independence of the CMA is partially contrary to the IOSCO objectives of regulatory independence. Under such conditions, market and power shifts can easily endanger regulatory consistency and clarity through external or internal agency capture,[3] which is among the main reasons for systemic risks in capital markets, with dramatically negative financial effects.

To protect against the possibility of this undesirable development and to safeguard the independence of and increase the accountability of the regulator, it is intuitively appealing to suggest strengthening the parliamentary oversight of the CMA by the National Assembly of Kuwait. This is where another source of systemic risk becomes visible. Contrary to IOSCO Principles 1-5 requiring appropriate mechanisms of the accountability of the

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(1) Eman AlShareedah, ‘Ministers’ Political Responsibility for the Action and Activities of Public Institutions and Authorities’ (LLM thesis, Kuwait International Law School 2015) 185–193.

(2)The categorization of market regulators we rely upon comes from Stavros Gadinis and Howell E Jackson, ‘Markets as Regulators: A Survey’ (2006) 80 Southern California Law Review 1239.

(3) See Paul Rose &Christopher J Walker, ‘Dodd-Frank Regulators, Cost-Benefit Analysis, and Agency Capture’ (2013) 66 Stanford Law Review Online 9regulated entities, Congress, courts, and the agencies themselves have all recognized—even before Dodd-Frank—th»,»author»:[{«family»:»Walker»,»given»:»Paul Rose & Christopher J.»}],»issued»:{«date-parts»:[[«2013»,4,29]]}}}],»schema»:»https://github.com/citation-style-language/schema/raw/master/csl-citation.json»} , noting that “agency capture can occur for many reasons …whereby regulators anticipate taking or returning to jobs in industry and fear alienating the entities they regulate…agencies face pressure not only from those they regulate, but also from interest groups that represent the interests of investors and others who may benefit from, or be hurt by, a particular regulation. And…there may be undue pressure….by the politicians who helped those officials obtain their positions within the agency.”

regulator, the current legal structure does not seem to provide a complete model for full 'real time' first-level accountability of the CMA as a regulator[1].

The National Assembly of Kuwait practices parliamentary oversight through ex-post 'soft' mechanisms, such as parliamentary questions and committees,[2] and the 'hard' mechanism of parliamentary investigation that can result in ministerial responsibility.[3] In the case of the CMA, however, the use of the 'hard' mechanism, evoking ministerial responsibility for the purposes of safeguarding the independence of the capital market regulator, strengthening its accountability and improving its effectiveness, appears a counterproductive strategy that reveals certain limitations in the accountability of the CMA.

Formally speaking, given that the CMA is an independent administrative authority over whom the competent minister has only limited supervisory power, and no full control over policy, it seems disproportional and contrary to the constitutional foundation of the CMA to invoke the full responsibility of the minister. However, neither is the National Assembly in a position to hold the CMA directly responsible for its policies. This means that, given the constitutional structure and the institutional position of the CMA, there appears to be no reliable model for making the CMA, as a regulator, fully accountable for its policy, either ex-ante or in 'real-time'. The accountability of the regulator toward the government and legislator is ex-post, indirect and partial.

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(1)The second level accountability of the CMA for its decisions is secured through judicial review, see Part III.3. The second level accountability is unrelated to the accountability of the regulator as such, and practically it might have no effect upon it.

(2) See Art. 99 (parliamentary questions), and Art. 114 (right of the National Assembly to investigate any of the matters falling within its competence) of the Constitution of Kuwait.

(3) Art. 100-101 of the Constitution of Kuwait. On the scope and meaning of parliamentary investigation and ministerial responsibility, see Mohammad A. AlMoqatei, 'The Parliamentary Investigation in Kuwait: the Scope and Restrictions' (2013) 1 Kuwait International Law School Journal 1, and Mohammad A. AlMoqatei, 'The Parliamentary Inquisition of Ministers in Kuwait,' (2003) 3 Law Journal 26.

This is a by-product of 'constrained parliamentarianism', a system in which attempts to balance the power of the government are implemented by granting independence to a variety of 'balancing' institutions, including, for example, capital market regulators, the central bank, or a constitutional court with a slowly expanding power of review[(1)]. The CMA's position of apparently limited accountability is in line with a trend of constrained parliamentarianism to effectively create a new 'administrative branch' of the state endowed with extensive executive-like rule-making powers, less than a full accountability, and no clear position within a traditional system of the separation of powers[(2)].

Even if one assumes that, de facto, influence of the competent minister justifies invoking ministerial responsibility, the invocation might not be practically helpful in terms of securing accountability or improving long term effectiveness of the capital market regulator. As regulatory theories, backed by empirical evidence from other countries, show, there are generally two issues with legislative control (irrespective of its form) of regulatory agencies and regulated industries: the first of these is the informational asymmetry and the monitoring costs inherent in the principal-agent relationship between the principal (the parliament) and the agent, (the regulator or the governmental bodies)[(3)], with the second be-

(1) Ackerman (n 5).

(2) cf. Christopher DeMuth, 'Can the Administrative State Be Tamed?' (2016) Journal of Legal Analysis <http://jla.oxfordjournals.org/content/early/2016/03/10/jla.law003> accessed 24 April 2016, arguing that in many respects growth of the administrative state is by and large an already finalized departure from the traditional rule of law values.

(3) A principal-agent relationship arises when an agent has the authority to make decisions on behalf of the principal and the main problem of the relationship is information assymetry and monitoring costs, see Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.the theory of property rights and the theory of finance to develop a theory of the ownership structure of the firm. We define the concept of agency costs, show its relationship to the 'separation and control' issue, investigate the nature of the agency costs generated by the existence of debt and outside equity, demonstrate who bears these costs and=

ing the problem of regulatory capture[1].

Taken together, the two imply that an increase in legislative oversight is a result of moral hazard and, in the end, increases adverse selection. This is a well-studied phenomenon of markets and organizational relationships systematically producing distrust and rewarding low quality[2]. The moral hazard of principal-agent relationships means that the agent can misuse the principal's trust and change their behavior after becoming the principal's agent. Since the principal has limited information regarding an agent's actual work once they select them (information asymmetry), the principal needs to exercise costly monitoring of an agent, but lacks the resources and information necessary to assess either the agent's actions or the underlying motives for their actions.

=why, and investigate the Pareto optimality of their existence. We also provide a new definition of the firm, and show how our analysis of the factors influencing the creation and issuance of debt and equity claims is a special case of the supply side of the completeness of markets problem. The directors of such [joint-stock] companies, however, being the managers rather of other people›s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master›s honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. Adam Smith, The Wealth of Nations, 1776, Cannan Edition (Modern Library, New York, 1937

(1) Regulatory capture, among other things, implies that interest groups are at their most powerful when their interest lies in the production of inefficient regulation, where inefficiency is measured by the degree of informational asymmetry between the regulated industry and the political principal, see Jean-Jacques Laffont and Jean Tirole, 'The Politics of Government Decision-Making: A Theory of Regulatory Capture' (1991) 106 Quarterly Journal of Economics 1089.

(2) cf. Black (n 4) 786–790, and Niamh Moloney, EU Securities and Financial Markets Regulation (Oxford University Press 2014) 56, for a discussion of informational asymmetries in securities market.

To prevent damage to their interest, a rational principal (say, a parliament) having multiple agents starts equally surveying and distrusting all agents (i.e. multiple ministers and administrative bodies), honest and dishonest alike, and all their actions. Honest agents are then the first to abandon the principal-agent relationship, as they are the ones investing the most in the quality of their actions. This leaves only low-quality agents in the organization (adverse selection), since they invest relatively little in the quality of their actions and therefore have less to lose and more to gain. The end result is regulatory capture; the creation of informal interest groups with a stake in blurring the process of oversight and widening the informational gap between the agent(s) and the principal(s) so as to secure long-term rent extraction.

To simplify this somewhat arcane economic language, the bottom line is this: excessive ex-post supervision and oversight (be it governmental or legislative) and invocations of an agent's responsibility does not necessarily improve the quality of the agent's work and regulation, nor does it improve accountability. Its abundance can result in high quality honest agents having no incentive to remain in relationship or even become an agent. Those that do will be of lower quality, and having incentives to provide as much inaccurate information as possible for as long as possible.

III.1.2 Balancing Administrative Independence and Accountability

Applied on the institutional position of the CMA, the above theoretical analysis implies the following: frequent legislative invocation of the responsibility and a removal of a minister who has limited supervisory powers without full influence over events after removal seems disproportional to the constitutional foundations of the CMA's authority and probably does not improve the functioning of the CMA or the capital market in general. It is a legal and political risk that can mutate into a systemic capital market

risk, precisely what the CMA Law and IOSCO objectives are supposed to prevent[1].

However, even ‘softer’ forms of continuous limited governmental supervision of the regulator or parliamentary oversight through, e.g., parliamentary questions and committees investigating the work of the responsible minister, can have an effect of decreasing the independence of the regulator and the quality of regulation without increasing its accountability. Under conditions of the overload of highly technical capital market information and the principal-agent relationship of the legislature towards the government and, in turn, the regulator (in order of supervision), the process of oversight is easily obscured. An over- or undersupply of information, and the potential for its misinterpretation, can eventually drive out both honest principals and agents and leave only the self-interested, creating systemic risk without either protecting the regulator’s independence or increasing its accountability.

There are, in theory, three ways to avoid these negative developments that are present in the process of oversight of any administrative body with a large degree of independence. The first and most common is the strengthening of the legislative ex-ante influence on the appointments of capital market regulators and other administrative bodies. The second is the strengthening of the continuous legislative supervision of the regulator. The third is a requirement that the direct ex-post responsibility of the administrative regulator is to the legislator[2].

(1) In the post-2010 period, markets have reacted negatively to disputes between the National Assembly, the government, and the CMA, see ‘Kuwait Replaces Head of Market Regulator after Political Backlash’ Reuters (26 August 2014) <http://www.reuters.com/article/kuwait-regulator-markets-idUSL5N0QW0YO20140826> accessed 19 April 2016. For a further overview of legal and political risks in Kuwait see Mohamed A Ramady, Political, Economic and Financial Country Risk: Analysis of the Gulf Cooperation Council (Springer Science & Business Media 2013) 95–116.

(2) cf. Herwig CH Hofmann, Gerard C Rowe and Alexander H Türk, Administrative Law and Policy of the European Union (Oxford University Press 2011) 760–761.

The first method does not seem to fit in neatly with the current constitutional structure in Kuwait, which does not directly require the National Assembly of Kuwait to consent ex-ante to appointments to administrative bodies. The second method is inadvisable, since it endangers the CMA's independence and is already secured by (and conflicts with) the legislative and constitutional requirements of limited government supervision. Hence, the third method of strengthening both the independence and accountability of the CMA appears feasible: requiring a direct 'joint and several' responsibility of the Chairman of the Board of Commissioners of the CMA and the responsible minister to the National Assembly. This proposal appears in line with the letter and goals of the CMA Law and the wider constitutional structure. The rule-making and enforcement power of the CMA is near-equivalent to an executive one, and the position of the Chairman of the Board of Commissioners of the CMA is de facto equivalent to that of the Minister of Finance in terms of budgetary decisions. Therefore, accountability of the Chairman of the Board of Commissioners of the CMA should follow the same pattern even if, formally, only the competent minister can be held responsible[1].

Because of the importance of capital markets, and especially after the 2008 financial crisis, the above proposal also falls in line with well-accepted practice in many countries where legislatures now regularly hold capital market regulators directly accountable for their actions[2]. Even so, the main line of criticism against the

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(1) cf. AlShareedah (n 46) for a similar proposal on different grounds.

(2) An interesting example in this respect is the relationship between the German capital markets regulator (Federal Financial Supervisory Authority, BaFIn), the German Ministry of Finance, and the German Parliament (Bundestag) standing finance committee. The Federal Financial Supervisory Authority (BaFIn), as an independent institution, is part of the federal administration, legally and technically supervised by the German Ministry of Finance, see BaFin,'BaFin - Data & Documents - Principles Governing the Exercise of Legal and Technical Supervision of BaFin by the Federal Ministry of Finance'

http://www.bafin.de/SharedDocs/Aufsichtsrecht/EN/Satzung/aufsicht_bmf_bafin_en.html> accessed 31 March 2016. However, the German Parliament's standing financial committee has a lead role in matters related to financial markets and a jurisdiction identical to that of the Ministry of Finance, see 'Finanzausschuss' (Deutscher Bundestag) http://www.bundestag.de/finanzausschuss> accessed 31 March 2016.

proposal of increasing the direct ex-post legislative accountability of the capital market regulator is obvious: although this might improve accountability, this is potentially at the expense of further endangering regulator's independence and expertise for reasons already outlined (informational asymmetry, moral hazards, and adverse selection), causing systemic risk.

In short, as IOSCO admits, no perfect balance between the independence and accountability of the capital market regulator (or administrative bodies as such) exists[1]. Choosing one over another involves unavoidable tradeoffs. However, sustaining at least a relative balance between the independence and accountability of a capital market regulator is an important task, in line with both the CMA Law and IOSCO standards.

III.2. Clarity and Consistency of the Regulatory Process and Human Resources

Two important principles pertaining to regulators' work, IOSCO Principles 4 and 5 of clarity and consistency of regulatory processes and the requirement for regulator staff to act in a skilled and professional way in their work, are, in practice, interconnected matters, since the quality of human resources precedes and creates clear and consistent regulatory processes. When measured against these principles, formal compliance of the CMA Law is high[2]. However, effective compliance is another matter that depends (and will continue to depend) on a will to successfully implement applicable law and other regulations, and to continuously invest in the improvement of policy expertise. We base this evaluation on two arguments, elucidated below.

The CMA's historical record of securing clarity and consistency of regulatory processes in the period between 2010 and

(1) IOSCO, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (n 8) 26–29.

(2) See Art.3-5 of the CMA Law and 'Capital Markets Authority - Charter of Code of Ethics for CMA Commissioners and Employees' (n 43).

2014 is hardly exemplary. A single example will suffice. During 2014, even though the Kuwait capital market suffered economic setbacks, reputable and highly publicized investment funds took longer than two years to be licensed by the CMA to work in the market. The delay was due to the CMA's lack of clear regulatory policy regarding licensing of capital market participants and later inconsistencies in the application of licensing rules(1).

Similar can be said for the application of Principle 5, requiring regulators staff to act in a skillful and professional way in their work. As the Kuwait Economic Society recognized, as late as 2015 the CMA still lacked the human resources necessary for successful functioning despite having existed for over five years(2). The CMA is hardly the only capital market regulator with this problem. As Carvajal and Eliot note, capital market regulators around the world lack staff skilled enough to understand the functioning and risks of capital markets while simultaneously being able to produce measures necessary to control these risks(3). This deficiency is therefore widespread and will likely persist, as skilled staff with proficiencies in technical issues of securities market regulation are difficult to come by, train, and, most importantly, retain.

IOSCO Principles 4 and 5 are in themselves demanding and difficult to apply consistently. The capital market is a complex one, and, by its very nature, highly volatile and open to external and internal economic shocks, requiring continuous expansion of expertise. Therefore, we recommend the CMA invest in the

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(1) Abdullah Al Kharafi and Abdullah Alharoun, 'Kuwait' in Jeffrey Golden (ed), The International Capital Markets Review (4th edn, Law Business Research, 2014) 222–223, 231 n30.

(2) 'KUNA :Kuwaiti Market Lagging behind Regional Ones - KES Official 08/03/2015' http://www.kuna.net.kw/ArticlePrintPage.aspx?id=2428677&language=en>accessed 31 March 2016.

(3) Ana Carvajal and Jeniffer Eliot, 'Strengths and Weaknesses in Securities Market Regulation: A Global Analysis' (2007) International Monetary Fund Working Paper 07/529 5, 29–30.

research of capital market policy and the appointment and hiring of experts necessary for this. The legislator has already empowered the CMA with a discretion to do exactly this, in Art. 14 of the CMA Law[(1)].

We are aware, however, that our recommendation requires a balancing of costs and benefits. The cost of hiring experts and investing in research is immediate and usually high, whereas the benefit gained from fully understanding complexities of the capital market is intangible and difficult to quantify in both the short and long term, since capital markets constantly change, causing rapid obsolescence of the expertise acquired and of the policy based on it[(2)].

III.3. Rule-Enforcement and Supervisory Powers of the CMA and the Capital Markets Courts Review

In compliance with IOSCO Principles 1-5 and 10-12, the CMA's powers of rule production, enforcement, supervision, inspection, and investigation are well defined. They cover not only rule-production, but also the supervision of capital market participants' personal and institutional activities directly or indirectly related to the capital market. In the process of supervision, the CMA can cooperate with other domestic supervisory authorities and foreign capital market regulators. High monetary fines sanction non-compliance with the CMA's enforcement and supervisory decisions, and decisions are open to judicial review by the specialized capital markets courts established by the CMA Law[(3)].

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(1) "The Board may establish permanent or temporary advisory committees and entrust them with studying a certain topic falling within its authorities as stated in this Law. The Board may hire experts from outside the Authority to accomplish the committees' tasks."

(2) cf. Schwarcz (n22) 815, 819, arguing that investors also have little long term incentive to invest in understanding the complexities of securitization.

(3) See Art. 4-5 (rule production and supervision), Art. 117-147 (penalties and sanctions), and Art. 108-116 (juridisction and functioning of the capital markets courts) of the CMA Law.

As noted already, we categorize the CMA as a government-led capital market regulator, broadly similar to models adopted in countries influenced by French and Germanic civil law traditions[1]. However, in a 'pure' government model of capital market regulation, the regulator controls and supervises the securities market with relatively limited supervisory and enforcement powers, while the judicial review of the regulator's supervisory decisions is left to the already-existing courts. In other words, the classical government model of capital market regulation is primarily concerned with preserving market standardization and channels of direct or indirect influence on the operation of market institutions, but, somewhat paradoxically, less concerned with the enforcement of a securities law[2].

The CMA Law differs from this route, as it grants much more independence and stronger supervisory powers to the CMA than enjoyed by its fully government-controlled counterparts in other countries. Furthermore, it establishes two-level specialized capital market courts, which should secure a more consistent and speedy enforcement of securities regulation and CMA supervisory decisions. This is a bold move, in our opinion, in the right direction[3], likely attributable to the negative experiences of in-

(1) Gadinis and Jackson (n 47).

(2) ibid 1278–1279. Gadinis and Jackson created their categorization before the 2008 financial crisis. After 2008, the more expansive model of administrative regulation of the capital market was grudgingly accepted, even in places where this was previously unlikely, see Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), and for further discussion Schwarcz (n 22) 816 and n4.

(3) Black also argues specialized capital markets courts are indispensable for the creation of strong capital markets, see Black (n 4) 791. Creating or using already existing courts as specialized capital markets courts appears only a very recent trend. After the 2010 passage of the Dodd-Frank Act, the US Security Exchange Commission (SEC) files most of its administrative proceeding in its 'in-house' Administrative Law Courts specialized in securities and financial law, see Tyler L Spunaugle, 'The SEC's Increased Use of Administrative Proceedings: Increased Efficiency or Unconstitutional Expansion of Agency Power?' (2015) 34 Review of Banking and Financial Law 406.

sider trading and deficiencies in the pre-2010 Kuwaiti capital market.

However, practitioners describe the CMA's decisions made in the course of exercise of its rule-enforcement and supervisory powers in the period from 2010 to 2014 as somewhat rigid, unappreciative of the overall nature of the capital market and the goals of the CMA Law, and rather slow. Similar can be said for capital markets courts. Although the capital market courts have only two levels, in 2013 the Court of Appeal was slowly deciding a total of only 116 cases under review, mostly involving the two-to-three-year-old issues of the licensing of individuals, companies and funds to practice capital markets activities[1].

A further complication is that in the period from 2010 to 2014 neither the CMA nor the capital markets courts reported or published their decisions regularly and in a timely fashion. Publication of court decisions frequently lagged a year or more behind the date of judgment, and there is no centralized easily accessible database with up-to-date user-friendly judicial decisions[2].

At the time of writing this paper, we have no reliable information on whether the situation has improved, remained the same, or deteriorated. Assuming things are the same, this is an issue that requires improvement, as regulators' and courts' decisions, available in real time, are important information that affects market participants' decision-making processes and increases their sense of legal certainty, which is the objective of both the CMA Law and IOSCO[3]. While the CMA has sufficient powers and resources to self-improve (and appears to be doing so), the soft spot remains capital markets courts.

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(1) Al Kharafi and Alharoun (n 63) 228 and accompanying notes.

(2) ibid 227–231.

(3) Art.3 (3) of the CMA Law and IOSCO, 'Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation' (n 8) 10.

However, this is a larger issue of the effectiveness and predictability of court decisions that transcends the capital markets and cuts across the entire Kuwaiti court system. As the 2012 Kuwait Ministry of Commerce and Industry and the World Bank Report show, the court system in Kuwait is well organized and the judiciary is certainly unbiased and independent. The problem is that the lack of judges specializing in general commercial issues (let alone complex securities issues) makes market participants consider court outcomes highly unpredictable and decreases confidence in the court system.1 The court's slow pace remains a major issue. To illustrate using the indirect example of enforcement, on average, the enforcing party in Kuwait must succeed in no less than 50 court procedures over 566 days in order to enforce its claim, at a cost of 18.8% of the claim[2].

The CMA Law has established what on the face of things appears to be a very effective and wide system of rule-enforcement and supervision and judicial review through specialized courts. Yet the system's predictability and the speed of functioning is still in the making, and requires continuous improvement. The CMA already has the legal authority and resources for self-improvement within its own limits. However, improvement in functioning of the capital markets courts is a more complex matter that transcends the confines of the capital markets, and for the resolution of this we recommend the creation of properly specialized training program for strengthening the judicial capacity for resolving complex capital markets disputes[3].

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(1) The World Bank, 'Report on the Observance of Standards and Codes. Insolvency and Creditor/Debtor Regimes: Kuwait' (2012) 12

http://www.kuwaiticr.info/Docs/Kuwait%20ICR%20ROSC%20(Final%20-%20Dissemination%20Site).pdf> accessed 13 March 2016.

(2) ibid 4.

(3) cf. ibid 1, making a similar recommendation for insolvency cases in Kuwait.

IV. Accounting and Auditing Standards

IV.1 Between the Formal and Factual Acceptance of International Accounting and Auditing Standards

The capitals market is fundamentally an information market, which explains why IOSCO and capital market regulators insist on the disclosure of information regarding risk exposure and the financial health of capital market participants. In this process, the development of reliable accounting and auditing standards is considered indispensable, as already argued in Part I.3. Increased standardization of accounting and auditing standards between countries is meant to produce the information that equally guides, in spite of their different interests, the investors, shareholders, regulators and rating agencies in their respective decision-making processes. Such information serves two purposes. In good times, it increases market confidence and serves as a cornerstone of corporate governance. In bad times, it signals the depth and course of market troubles, prompting the regulatory intervention that is often necessary to prevent systemic market risk.

The most pressing and persistent problem, however, remains the gap between the formal and de facto application of accounting and auditing standards within the country. Around the world, in spite of formal acceptance of the IFRS or any other type of accounting or auditing standards, in-country application is far from consistent or reliable. To illustrate, the concealment and 'repackaging' of crucial accounting information by one of the largest accounting and auditing firms, Arthur Andersen, was a snowflake starting an avalanche that ultimately caused a large enough degree of systemic risk to crash the market, prompting the enactment of the Sarbanes-Oxley Act of 2002 and a substantial change in the SEC's attitude toward transparency and disclosure[1]. Decreasing trust in auditors' independence and pro-

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(1) Ray Ball, 'Market and Political/Regulatory Perspectives on the Recent Accounting Scandals' (2009) 47 Journal of Accounting Research 277.

fessionalism led the Sarbanes-Oxley Act to end the self-regulation of the auditing profession and establish the formally private but de-facto quasi-administrative public body, the Public Company Accounting Oversight Board, whose mission is to protect the interests of investors in the preparation of informative, accurate, and independent audit reports[1].

The history of financial reporting and the application of accounting and auditing standards in Kuwait is relatively long and marked by periodical changes. For complex reasons, the accounting and auditing standards used in the period from 1962 to 1990 were largely an idiosyncratic mix of British standards and other Arab countries' models, adjusted to local circumstances.2 In spite of various direct or indirect regulations, such as the External Auditing Law No. 5/1981 and the Decree on the Auditing Profession, the standards of accounting and auditing as applied remained loose, their application being supervised and controlled only minimally. This has had predictably negative consequences for the capital market. A number of authors argue the crash of the Kuwaiti stock market in 1982 was directly attributable to the lack of uniform regulation and application of accounting standards, causing a market failure[3], prompting, in turn, the founding of the new, self-regulated Kuwait Stock Exchange[4].

Beginning in the 1990s, as a response to continued weaknesses of the financial reporting system in Kuwait, Resolution No. 18 of 1990 of the Ministry of Commerce and Industry required all companies operating in Kuwait to adopt international

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(1) Public Company Accounting Oversight Board, 'The Importance of Auditing and Audit Regulation to the Capital Markets'
http://pcaobus.org/News/Speech/Pages/03202014_American.aspx> accessed 16 April 2016.

(2) Moustafa Wagdi Abdallah, Managing Multinationals in the Middle East (Greenwood Publishing 2001) 31.

(3) See, i.e., Abdulla K Al-Qahtani, 'The Development of Accounting Regulation in the GCC: Western Hegemony or Recognition of Peculiarity?' (2005) 20 Managerial Auditing Journal 217,225-226; and Abdallah (n 80) 31.

(4) Alfaraih (n 35) 21–23.

accounting standards for the financial period beginning January 1st, 1991. Later amendments to the Law on Commercial Companies required companies listed upon the Kuwait Stock Exchange to prepare annual financial statements in accordance with the IFRS and submit them to the Ministry of Commerce and Industry and companies' shareholders, while the regulations of the Kuwait Central Bank were in charge of the banks and financial institutions. The Kuwait Stock Exchange regulations further increased periodical disclosure demands, requiring all companies listed upon the stock exchange to submit reviewed quarterly financial statements, prepared in accordance with the IFRS at the end of each quarter(1).

The CMA Law has inherited these requirements of periodical disclosure and left them largely unchanged. It further strengthened overall transparency, imposing an obligation of mandatory disclosure of various material information and interests on a wide range of direct or indirect participants in the capital market, natural and legal persons alike(2). This model, again, is most likely a result of the pre-2010 regulations in the Kuwaiti capital market, when disclosure measures were vaguely defined, and sanctions for non-disclosure and insider trading were deemed an insufficient deterrent(3).

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(1) ibid 15–33.

(2) See Art. 3(5) and Art. 100-107 and related provisions of the CMA Law .

(3) Bouresli (n 2).the regulations governing it do not stand for its size and value. The market is functioning under a decree that was drafted in 1983 as a reaction to Al Manakh stock market crisis. In this study, we examine the extent to which the securities market complies with the international best practices and the IOSCO objectives. An intensive diagnostic analysis is performed, in the light of the field study and the World Bank FASP report, to explore all major shortages and deficiencies associated with the regulatory and organizational structure of the securities market. The investigation revealed that the securities market infrastructure does not comply with the international best practices issued by the IOSCO organization. The results show that Kuwait was not able to achieve a fully implemented or broadly implemented score in any of the 30 assessors examined in both the analysis performed in this study or in the World Bank Report performed four years ago which confirms the fact that the securities market is poorly regulated and suffers from serious weaknesses. Further=

While the drive to impose more disclosure is a usual response of most regulators seeking to increase capital market transparency and reduce systemic risk[1], the main problem with disclosure is not how much of it is legally required, but how it is undertaken. If there is no underlying reliable standardized system for collecting and interpreting information, and no 'common language' for communicating those – in this case standardized and effectively applied financial reporting standards – the disclosed information is of little use. Its abundance can inadvertently (and sometimes strategically) distract, obscure and conceal, rather than disclose and reveal anything[2]. As almost all capital market failures in the last two decades have shown, increased transparency combined

=more, the study lists the requirements needed to achieve a fully implemented score. Finally, a list of recommendations was provided for each shortcoming addressed in a manner consistent with the market structure and legal environment. As a priority the government should take steps to pass a new comprehensive securities law that establishes a new regulatory independent authority.»,»author»:[{«family»:»Bouresli»,»given»:»Amani»}],»issued»:{«date-parts»:[[«2009»]]}}}],»schema»:»https://github.com/citation-style-language/schema/raw/master/csl-citation.json»}

(1) See Iman Anabtawi and Steven L Schwarcz, 'Regulating Systemic Risk: Towards an Analytical Framework' (2011) 86 Notre Dame Law Review 1349, 1369 and accompanying notes.

(2) cf. Ferran and Ho (n 2) 465–465. On the pitfalls and unintended consequences of legally mandated disclosure see Omri Ben-Shahar and Carl E Schneider, 'The Failure of Mandated Disclosure' (2011) 159 University of Pennsylvania Law Review 647, 679–690. One (among many) theoretical argument against regulator-imposed mandatory disclosure is that it favors informed managers with political connections and influence while disfavoring shareholders, see Jeremy Bertomeu and Robert P Magee, 'Mandatory Disclosure and Asymmetry in Financial Reporting' (2015) 59 Journal of Accounting and Economics 284.a majority of managers chooses disclosure rules with which all firms must comply. In equilibrium, disclosure rules are asymmetric with greater levels of disclosure over adverse events. This asymmetry is positively associated with the informativeness of the measurement and increasing in the level of verifiability and ex-ante uncertainty of the information. The theory also offers implications about the relation between mandatory and voluntary disclosure, when both channels are endogenous.»,»DOI»:»10.1016/j.jacceco.2014.08.007»,»ISSN»:»0165-4101»,»journalAbbreviation»:»Journal of Accounting and Economics»,»author»:[{«family»:»Bertomeu»,»given»:»Jeremy»},{«family»:»Magee»,»given»:»Robert P.»}],»issued»:{«date-parts»:[[«2015»,4]]}}}],»schema»:»https://github.com/citation-style-language/schema/raw/master/csl-citation.json»}

with the absence and/or abuse of accounting and auditing standards is a source of information asymmetry. Under conditions of market complexity, abundance of disclosure increases moral hazard and attracts risk transferring, under-detection of interconnections between markets and institutions, regulatory arbitrage, and ultimately wealth transfer between the local and international markets, causing systemic fragility and risk[(1)].

The CMA Law gives the CMA the authority to prescribe concrete financial statement standards that capital market players should use, and briefly states at various points that companies listed in the securities exchange will prepare financial statements in accordance with the securities exchange regulations approved by the CMA[(2)]. It appears that in the period from 2010 to 2015, the CMA approved or produced few detailed instructions that would clarify everyday problems of the application of the rather vague IFRS standards by capital market participants. Rather, the CMA has focused on 'second level control', subjecting audited financial statements to review and conducting the quality control of work done by auditors registered by the CMA[(3)].

In spite of the focus on second level control through audit and the formal requirement of preparing financial reports according to the IFRS standards, empirical studies show the actual application of the IFRS in the Kuwait capital market remains largely lax and uneven[(4)]. This greatly diminishes the reliability of the overall informational value of financial statements, with possibly

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(1) See Ball (n 78) and Dan Awrey, 'Complexity, Innovation, and the Regulation of Modern Financial Markets' (2012) 2 Harvard Business Law Review 235, 275–276.

(2) See, i.e. Art. 95-97 and Art. 69 1(4) of the CMA Law. Accounting and auditing for companies in Kuwait is also regulated by Companies Law No. 1 of 2016, see Art. 109-114, Art. 128-133 , Art. 221-226, and Art. 227-233. Further see Executive Bylaws to the Companies Law No. 25 of 2012 amended by the Law No.97 of 2013, Art. 40, Art. 73-76, and Art. 183-185.

(3) See Art. 65 of the CMA Law and Executive Bylaws of the Capital Markets Authority Law No.7 of 2010, book 5, ch. 3, Art. 3(4)1 – 10.

(4) Alfraih and Alanezi (n 35).the level of compliance with mandatory IFRS disclosures of Kuwait Stock Exchange (KSE

far-reaching negative consequences, especially given the experience of the 1982 stock market crash.

For this reason, we consider the CMA Law and the CMA's regulations of accounting and auditing formally partially compliant with IOSCO's principles on international accounting and auditing standards, with this being partially related to the institutional and market infrastructure and the pre-2010 regulations. The de facto application of the IFRS and, somewhat less, auditing standards in Kuwait requires a bottom-up improvement.

IV.2. Systemic or Piecemeal Regulation of Accounting and Auditing?

The dilemma of ensuring the reliable financial reporting of internationally comparable standards in capital markets can be resolved in two ways. The first, and more demanding, of these is engagement in a wholesale systemic legislation through enactment of a special law and/or setting up of a public or public-private body with the authority to issue and supervise application of accounting and/or auditing standards throughout the entire Kuwait capital market. After the financial crisis, such 'across the board' regulation is hardly unusual. Take, for example, the French Accounting Standards Authority (Autorité des Normes Comptables, or ANC), created in 2009 in the wake of the global financial crisis and simultaneous to the regulatory reform of the French capital market[1], or the already-mentioned Public Company Accounting Oversight Board.

The second, and more realistic, option would be for the CMA to simply rely on its already-existing powers to diligently enforce the application of accounting and auditing standards by the entities under its supervision. This piecemeal approach has already proven its effectiveness in other areas of market regulation. Evidence shows that the Central Bank of Kuwait has been able to sustain the stability of the Kuwaiti banking sector even in the

(1) See 'The Autorité des normes comptables (ANC) (The French accounting standard setter)' <http://www.anc.gouv.fr/cms/accueil.html> accessed 26 February 2016.

most difficult of times by vigilantly enforcing and supervising the application of accounting and auditing standards through regulations and standard-setting instructions.1 However, the Central Bank performed this as a ring-fencing measure, applied solely to the relatively small oligopolistic sector, comprised primarily of banks in which the government has a strong shareholding interest[2].

Judging by the content of the most recent Executive Bylaws, the CMA appears to have already moved in the direction partially charted by the Central Bank of Kuwait in terms of strengthening the supervision of auditing[3]. This is a commendable and less costly policy, in line with IOSCO Principle 19 (discussed in Part I.3, supra). However, this policy has its limitations. Considering the lax application of IFRS standards, it is highly uncertain whether capital market participants' processes of recording and interpreting financial transactions with smaller and larger private capital and quasi-capital market players produces sufficient information for performing reliable audits and making investment or regulatory decisions. A practical implication of this situation, one that foreign fund managers have already drawn, is that overall the capital market in Kuwait is opaque and its underlying foundations are prone to systemic risk[4].

For that reason, while the option of piecemeal enforcement and supervision of accounting and auditing standards by the CMA is intuitively the most appealing (and less costly) and already in place, we conclude that its limitations mitigate in favor of

(1) Capital Standards, 'Kuwait Banking Industry' 9–10
https://www.capstandards.com/CSR_Kuwait-Banking-Industry_November2009.pdf> accessed 26 March 2016.

(2) For data on the distribution of shareholders in major banks in Kuwait, see ibid 3.

(3) See Resolution No. (72) of 2015 of November 9th, 2015 – on Issuing the Executive Bylaws of the Law No. (7) of 2010 Regarding the Establishment of Capital Markets Authority and Regulating Securities Activities and its Amendments in Kuwait, and Executive Bylaws of the Capital Markets Authority Law No.7 of 2010, book 5, ch. 3, Art. 3(4)1 – 10.

(4) 'Kuwait Replaces Head of Market Regulator after Political Backlash' (n 57).

the systemic solution of the setting up of a public or public-private body with the authority to issue and supervise the application of accounting and/or auditing standards throughout the entire Kuwaiti capital market.

Conclusion

The enactment of the CMA Law and the reform of the capital market in Kuwait is probably among the most complex pieces of legislation enacted in Kuwait recently; an attempt to elevate the Kuwaiti capital market to the level of an emerging one. As we have shown, in many respects – from securing the relative independence of the CMA, to endowing it with powers and resources – the CMA Law is certainly highly compliant with IOSCO standards. Yet risks and challenges remain. Some of these, like the limitations of accountability, are related to the institutional positioning of the CMA. Others, i.e. informational asymmetry, moral hazard, and adverse selection, are related to the nature of the capital market and its administrative regulation. Yet others, i.e. the lax application of the IFRS standards, are inherited from the pre-2010 period, and are still present.

The CMA Law and the CMA as a regulator compose the apex of the administrative top-down reform of the capital market. Whether they will fully achieve their IOSCO-compatible objectives remains to be seen. As the 1982 stock market crash and pre-2010 developments show, the success of capital markets requires a great deal of bottom-up work. An additional complication is the path-dependency trait of markets, meaning that any change requires a great deal of time and a systematic approach to successfully implement. As cross-country studies of institutional reforms have already shown, piecemeal market reforms are unlikely to be effective if the effectiveness, transparency, and accountability of the overall economic system – and not only the capital market – do not increase.[1]

(1) Ray Ball, 'Infrastructure Requirements for an Economically Efficient System of Public Financial Reporting and Disclosure' (2001) 2001 Brookings-Wharton Papers on Financial Services 127.

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