November 2004
IMF Country Report No. 04/352

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

This Detailed Assessments of Observance of Standards and Codes on the IOSCO Objectives and Principles of Securities Regulation for **Kuwait** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **October 2004**. The views expressed in this document are those of the staff team and do not necessary reflect the views of the government of **Kuwait** or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623 7430 ● Telefax: (202) 623 7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

FINANCIAL SECTOR ASSESSMENT PROGRAM

KUWAIT

DETAILED ASSESSMENTS OF OBSERVANCE OF STANDARDS AND CODES—INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSION (IOSCO)—OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

OCTOBER 2004

INTERNATIONAL MONETARY FUND
MONETARY AND FINANCIAL SYSTEMS
DEPARTMENT

THE WORLD BANK
FINANCIAL SECTOR VICE PRESIDENCY
MIDDLE EAST AND NORTH AFRICA REGIONAL
VICE PRESIDENCY

Contents Page

Glossary 3

A. Summary Assessment of Implementation of the IOSCO Objectives and 4
Principles of Securities Regulation 4
B. Information and Methodology Used for the Assessment 4
C. Structure and Role of the Securities Industry 4
D. General Preconditions for Effective Securities Regulation 7
E. Main Findings 8
F. Summary of Principles Assessment 10
G. Principle-by-Principle Assessment 14

Tables
1. Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation 15
2. Summary Observance of the IOSCO Objectives and Principles of Securities Regulation 36
3. Recommended Plan of Actions to Improve Observance of the IOSCO Objectives and Principles of Securities Regulation 36

GLOSSARY

AIMR	Association for Investment Management and Research
CBK	Central Bank of Kuwait
CD	Company Department
CISs	Collective investment schemes
CSD	Clearing, Settlement, and Depository
DVP	Delivery versus payment
GCC	Gulf Cooperation Council
IAS	International Accounting Standards
IOSCO	International Organization of Securities Commission
IPF	Investor Protection Fund
KATS	Kuwait Automated Trading System
KCC	Kuwait Clearing Company
KSE	Kuwait Stock Exchange
MC	Market Committee
MOCI	Ministry of Commerce and Industry
MOF	Minister of Finance
MOU	Memorandum of Understanding
NAV	Net asset value
SGF	Settlement Guarantee Fund
SRO	Self-regulating organization

A. Summary Assessment of Implementation of the IOSCO Objectives and Principles of Securities Regulation

1. The assessment of the securities regulatory system in Kuwait was performed as part of the Financial Sector Assessment Program for Kuwait in July and September 2003. The assessment is of the legislative and regulatory frameworks, the operations of the regulating agency, the Kuwait Stock Exchange (KSE) and the trading, clearing, settlement, and other operational systems, as well as market intermediaries. The main purpose was to assess the observance of the International Organization of Securities Commission (IOSCO) objectives and principles of securities regulation, the effectiveness of market supervision, and to suggest areas where further improvement and development may be appropriate.

2. This assessment is based upon a review of laws, rules and regulations, documentation and reports on the market and its operations, interviews with government officials, the KSE management and staff, legal experts, and representative of market participants and intermediaries members of the securities industry as well as with some investors. These interviews were supplemented with a set of self-assessment reports prepared by the KSE, additional reference materials and other publicly available information. The Central Bank of Kuwait (CBK), the Ministry of Commerce and Industry (MOCI), and KSE cooperated fully with the assessment, which was conducted by Ashraf Shamseldin, Securities Advisor, IMF, July 1–10 and September 6–18, 2003.

B. Information and Methodology Used for the Assessment

3. The assessment is based on the methodology developed by IOSCO,[1] the benchmarks and scale of observance provided to evaluate the implementation of each principle. The assessment is primarily concerned with whether the objective of the principle is sufficiently met from two perspectives: (i) from a legal perspective, by identifying the powers and authorities conferred on the regulator, the relevant provisions of applicable laws, rules and regulations, and the programs or procedures intended to implement these that form the framework of securities regulation; and (ii) from the perspective of the exercise of those powers and authorities in practice and how powers are being exercised and whether enforcement of the framework is efficient. The assessment is, therefore, concerned with the existence of an appropriate legal and regulatory infrastructure and the existence of the powers and capacities of the regulating agency(s) for these purposes. It is not meant to assess the application of this infrastructure to particular cases.

C. Structure and Role of the Securities Industry

4. The securities market in Kuwait is regulated by the Market Committee (MC)/KSE, the CBK, and the MOCI. The MC and the KSE were established by Decree-Law in 1983 with the objective of protecting investors in securities and organizing and developing the securities market. These two institutions, as well as the CBK and the MOCI, are responsible

[1] Revised in April 2003.

for regulating and supervising the securities markets, securities issuers, intermediaries, and other institutions, and for helping the government in matters related to regulation of these markets.

5. The MOCI is responsible for licensing securities market intermediaries and for the regulation and supervision of the primary market. The CBK is responsible for the supervision of collective investment schemes (CISs). The regulatory powers are fragmented without sufficient formal coordination procedures.

6. The securities market in Kuwait is the second largest in the Arab world in terms of value of trading (US$22 billion) and market capitalization (US$35 billion).[2] The market has regained momentum and has grown fast since the crash of 1982 and following the promulgation of the new market law in 1983. The KSE was established in the same year and the MC was commissioned as a regulating agency; both are known as the "Kuwait Securities Market" or *Suq-al-Awraq al-Malia.* The Exchange was closed in August 1990 after the Iraqi invasion and trading operations were suspended for two years (the exchange was reopened in September 1992).

7. While the market crash in 1982 resulted in a total loss of investors' confidence and consequently market dormancy for some time, trust was gradually regained and the market became active, particularly with the introduction of the Kuwait Automated Trading System (KATS) in 1995.

8. In 1988, investment barriers were removed for the citizens of the countries of the Gulf Cooperation Council (GCC) who have been permitted to hold shares in Kuwaiti companies and to trade on the KSE. The GCC companies were also allowed to list on the KSE. This development has activated the market and boosted investors' confidence and trust. In August 2000, the market was opened to all foreign investors, especially from other Arab countries.

9. The market is emerging with a marginal role as a source of medium and long-term finance. The market capitalization in 2002 represents about 100 percent of GDP, and the turnover ratio was 11.6 in 2002. The primary market is not active and lacks basic services. Despite high market liquidity, it has a rather limited volume of issued stocks. Business relies more on the banking system to provide finance at a higher cost. Equity is the major financial tool in the market, as bond issues are very few (mainly government bonds of medium-term maturity; corporate bonds are limited). There are no derivative products available on the Kuwaiti market.

10. Investment in securities is not as popular as bank deposits, mainly due to the speculative nature of investors and high market volatility.

11. Institutional investors are few; and institutional investment is mainly passive and has not spurred the development of financial instruments and techniques. However, the

[2] 2002 figures.

investment fund industry is growing and by the end of 2002, there were 33 licensed funds with total assets of slightly more than US$3 billion.[3] These funds and all portfolio management companies are supervised by the CBK as well as MOCI. No information on the size of their portfolio investments or their investment objectives is available.

12. The regulatory framework is basically concerned with the organization of the secondary market with less attention given to the primary market and the securities industry. Investors require more protective measures at the issuing stage for securities. Offering of securities needs to be organized and regulated by a sufficient, standardized, and detailed set of prudential rules, with clear procedures in accord with listing and trading rules. At present, publicly offered securities are listed on the KSE after one year, while nonpublicly offered securities can only be listed after three years.

13. The securities industry is thin, with nondiversified, small intermediary firms. There are 13 licensed brokerage firms, which are not allowed to perform proprietary trades. The total number of entities under the supervision of the CBK, which are licensed as investment companies (fund management and portfolio management), is 71. With the exception of brokerage, investment firms are allowed to render multiple services and are licensed as multipurpose companies. Meanwhile, there are no clear prudential rules and regulations addressing standards of conduct, ethics, and avoidance of possible conflict of interest. Standards for market entry and prudential prerequisites for licensing are not sufficient. Banks are not allowed to conduct securities business except through affiliated firms. Not enough information is made available or easily retrievable on the number and size of these intermediaries. While the KSE keeps information on brokers, the CBK and the MOCI keep information on investment funds and other investment service companies, respectively, with little publication.

14. The KSE is the only national stock exchange in Kuwait. It is a government public entity and operates as a cash market. A parallel system was operated in 1998 for forward trading although very small in size. In 2002, 95 companies were listed on the KSE. The total volume of traded shares is about 27,834 million. At the moment, no derivatives are traded in the Kuwaiti market. Bond trading can take place through the electronic KATS system, but there is no bond dealing/market making service available yet. There is also an over-the-counter market in equities in Kuwait, and the KSE developed a set of rules governing trading in this market. The trading system provides transparent, up to date, and reliable information about trading and the companies listed on the KSE. It is designed to deal with turnover several times larger than at present. Companies are delisted in case of noncompliance with trading rules and disclosure.

15. Equity and debt trades on the KSE are cleared and settled through the Kuwait Clearing Company (KCC), the sole company established for this purpose. It works under the umbrella of the KSE as a central clearing and settlement agent and also acts as the securities

[3] Equivalent to about 6 percent of the total assets of local banks and 31 percent of the total assets of investment companies in Kuwait—see *CBK Economic Report* (2002), pp.150.

depository and registry. Custodial services for non-Kuwaiti investment are provided by banks. The KCC was founded by major banks that function as payment banks, the KSE, and a few market intermediaries. In the system developed by the KCC, securities are immobilized and not dematerialized.

16. In Kuwait traders are allowed to open accounts in the Clearing, Settlement, and Depository (CSD) system; these accounts are also used to trade in the KSE trading system. One beneficial owner is allowed to open one account only. Brokers act as agents and take full responsibility for the performance of their clients. In order to avoid risks of a broker default, market rules dictate that the investor pay for a buy trade directly to the CSD, while the CSD initiate a payment on a sale trade which is paid in the name of the investor, thus cash is transacted between the CSD account and the investors' accounts. The KSE has a surveillance mechanism through which the trading activities are monitored to detect any unusual activities. To better control market volatility in a given day each security has its own market up/down limit. Once the limit is reached, a security cannot be traded further during that day.

17. The KCC safe-keeps securities in immobilized form. Even though safekeeping of securities with the KCC is optional, settlement through the KCC is mandatory and all settlements are done electronically by transferring assets between investors' accounts held within the KCC system. Penalties are imposed on members if they fail to meet obligation on settlement date.

18. The regulatory system in Kuwait does not explicitly and clearly recognize and organize self-regulation. For example, the KSE and the KCC are governed by a special set of rules and have their own management setting and structure, but they are not officially recognized as a self-regulating organization (SRO).

D. General Preconditions for Effective Securities Regulation

19. The regulatory environment for the securities market in Kuwait generally does not conform to the preconditions of the IOSCO objectives and principles. The securities market in Kuwait is an emerging market and requires due attention to its development. Although the law specifies this aim, there are no corresponding rules and regulations, nor clear responsibilities and powers to achieve this aim.

20. The securities law and its regulations were prepared in reaction to the market crash in 1982, with the aim of avoiding its reoccurrence, and probably under time pressure, thus leading to deficiency in major areas. In addition, no power was given to the regulating agency to develop the market as it evolves and to meet its changing needs without corresponding changes in legislation. The protection of minority shareholders and prohibition of market manipulation and insider trading are, for example, crucial areas that are not at all covered by present regulations. In addition, the developmental aspect of the legal framework is generally neglected.

21. The IOSCO principles require an appropriate and effective legal setting, tax system, bankruptcy law, and efficient court system, and accounting framework, within which the

securities markets can operate. Although these are in place, there is still room for improvement.

22. The need for market awareness and education is obvious and crucial. Such a need of company directors, managers, investment intermediaries and others involved in the securities industry can be met by the MC/KSE. The KSE seeks to implement an information and education program for all securities market participants. Accompanied by strong enforcement, these changes may help strengthen the confidence of investors.

E. Main Findings

23. The review of compliance with the IOSCO objectives and principles reveals that, while some progress has been made in the recent past in the regulatory and institutional aspects of supervision of securities markets, the underlying legal framework remains inadequate and in need of improvement. During the last few years, the MC/KSE, the MOCI, and the CBK, as regulators and law enforcement agencies, have issued a large number of regulations, circulars, and the like, and it is practically impossible to track them for comprehensive review purposes. In particular, they are not compiled in a consolidated master reference, and it is therefore difficult to assess accurately the level of compliance with international standards and principles. More seriously, market participants and investors cannot keep abreast of rules and regulations for compliance purposes. Rules and regulations are published in the Official Gazette and licensed intermediaries are informed by KSE correspondence of instructions and administrative decisions as they are issued. Firms are responsible for filing and keeping track of these instructions. This system is not efficient and seems unreliable. KSE has recently developed a web site and plans to post all rules, regulations, administrative decisions, and guidelines. It is also planning to develop a compendium or consolidated master reference for this purpose in the near future.

24. Although the law establishes broad mandates for supervision of the multiple entities involved in the securities market, the lack of regulatory harmonization has led to a significant fragmentation of responsibilities. Moreover, two key market participants, the KSE and the KCC, are not subject to the regulator's inspection.

25. From a statutory viewpoint, the MC is an independent agency but in practice it is not. In particular, the MOCI serves as chair of its board of directors; the director-general is appointed and can be removed; and the majority of the members of the board of directors are appointed by the government. The agency has only limited powers for fulfilling its mandate, as most of the powers of licensing, supervision, and sanctions lie elsewhere. The supervisory powers of the MC over the two key market institutions, namely the KSE and the KCC, are not sufficient. Moreover, the power to set technica1 standards for the market is fragmented and not coordinated. Meanwhile, the inspection, investigation, and surveillance powers of the MC/KSE are not adequate and, in particular, lack the power to supervise and inspect the key market institutions. The MC/KSE human resources need strengthening to increase efficiency. In recognition of this, there have been recent efforts to reorganize the supervision, surveillance, inspection, and investigation mandates both in scope and in quality.

26. The power to share information and coordinate actions with other regulators is legally permitted with respect to foreign authorities. The interpretation by the executive regulations of this law provision has limited the sharing of information to the public domain and non-confidential information only, as the law did not explicitly permit the sharing of all types of information. This is of concern especially with the market now open for foreign investment, and the exchange of information, whether public or otherwise, is important for law enforcement and investor protection. In addition, there are no formal protocols to streamline and institutionalize cooperation among national regulatory agencies and with other domestic supervisory and inspection authorities. The law needs to be amended to explicitly and clearly provide for such cooperation.

27. The clearing and settlement system prevents to a great extent payment default in case of the failure of a participant to meet his obligations. Dematerialization of securities cannot be efficiently and promptly implemented in the absence of a compelling law. It is expected, therefore, that the risk of delay in securities delivery would remain high and more so in the event of a bankruptcy of a clearing member. The plan to establish an investor protection fund (IPF) has so far not been implemented.

28. There are no SROs at present in a proper sense. Although the legal framework does not prohibit self regulation, it does not provide a set of clear rules for this purpose. While the stock exchange could have been recognized under the current legal framework as an SRO, the present organizational structure and administrative system do not support this view. The MC, which is the market regulator, acts as the exchange's board of directors, thus defeating the principle of self-regulation. The Kuwait Clearing Company (KCC) is a self-regulated entity under the supervision and oversight of KSE and thus it is implicitly and indirectly subject to the oversight of the market regulating agency.

29. Listing requirements are set by the KSE, subject to the approval of the MC and the MOCI. For a company to be listed on the exchange, it must have published audited financial statements for the three fiscal years preceding the listing application. Public offerings of securities are subject to a set of regulations that require the preparation of a prospectus and disclosure of complete and reliable information. This process is under the supervision of the MOCI. Such offerings cannot be listed on the exchange until one year following the publication of its audited financial statement for the first subsequent fiscal year. The relevance of the prospectus in this case becomes marginal due to insufficiency of information therein, whether at the date of offering or the date of listing. Investors invited for subscription, whether in an initial public offering or private placement, are not properly informed of the inviting company, the possible or potential risk involved in the investment, and therefore are not provided with adequate protection. In general, the regulation of the primary market is not sufficient and needs improvement. Also, there are no regulations or detailed disclosure rules on mergers and takeovers, on reporting transactions by insiders and any changes in significant shareholdings, and on the equal treatment of shareholders that aim at protecting the interests of minority shareholders and outside investors.

30. Licensing requirements for market intermediaries are few and broad. With the exception of brokers who are supervised by the KSE, requirements for other intermediaries are regulated by different agencies. The term "Investment Company" is not defined and

therefore not clear, and there are no rules to govern such a definition. Regulations related to intermediaries and intermediation are generally inadequate. Individuals are not licensed and no proficiency requirements are in place for traders, advisors, portfolio managers, compliance officers, or officers and directors of the investment firms and mutual fund managers. In the absence of these legal requirements, no relevant general guidelines have been issued.

31. The KSE has the power to enforce the relevant laws and regulations with respect to brokers only and can enforce sanctions (limited to warnings and revocation of licenses) but not fines. It uses an electronic surveillance system to detect any irregularities in market prices that might reflect attempts at market manipulation. Insider trading is not legally prohibited. Although the KSE has the authority to conduct regular inspections as part of its normal ongoing supervision of market participants, it carries out inspections only in cases of complaints by investors or reported fraudulent actions. This is largely due to lack of staff and technical capacity.

F. Summary of Principles Assessment

32. Strength of the regulator

- The securities market is regulated by more than one agency. Division of responsibility between them does not avoid inequities and leaves gaps. The various laws that govern the market do not form a comprehensive legal framework. Cooperation between the regulating agencies is not formalized and there are no legal procedures in this respect. The MC is the principal regulator, but has no staff and relies on KSE staff. Accordingly, the system does not guarantee the prevention of conflict of interest or abuse of discretion. The power and jurisdiction of the MC is limited, as it is confined only to the KSE and member brokers.

- While the law grants the independence of the MC/KSE, it is not, in practice, operationally independent from external political or commercial interference. The minister is the chairman of the board, which can create a political or policy conflict. Six members of the board represent the market players and business community, thus creating an obvious conflict of interest that may interfere with the fairness of the agency vis-à-vis licensed intermediaries. For improved transparency, the MC/KSE's financial statement should be published in the annual report. The sanctioning system that is currently applicable is too weak to keep the market in order. The MC/KSE needs to be empowered with pecuniary sanctions and a larger spectrum of sanctions.

- The regulatory process is not clear. Rules, procedures, and decisions are not available to the public. There is no consolidated master reference for these rules and executive decisions for easy reference for the different users. The regulatory agency does not consult with the industry, the affected parties or the public, as there is no established procedure for rule making. No comprehensive inspection procedure is in place and no regular inspection is performed. The outcome of the investigations or inquiries should be published to provide guidance to the market participants on problems that should be avoided. Inspection and investigation are not comprehensive; and they are not

intended to measure the intermediary's overall commitment to rules and regulations. The regulator has no subpoena powers, and it cannot call witnesses, or any other party to complete its investigations. Insider trading is not prohibited and consequently not penalized, which is of serious concern to the investors and intermediaries.

- The law allows cooperation with other regulators and agencies but the mechanism/procedures and the tools for this purpose have not been established. There is no provision in the law that specifically authorizes the MC/KSE to share nonpublic information with domestic and foreign counterparts. A provision to that effect should be promulgated. Information sharing procedures and mechanisms need to be in place and should be formalized by way of a Memorandum of Understanding (MOU). In addition, the MOUs, which have been signed between the MC/KSE and other markets, need to be in line with IOSCO standards for information sharing.

33. Self regulation

- As the market gains maturity and experience, the regulator envisages allowing future implementation of SRO principles. The law should be amended to allow for SROs to complement regulations, and should clearly state that the regulator oversees and inspects the activities of the SROs. The regulator should also be empowered to apply sanctions to SROs when established.

34. Issuer regulation

- A set of well-articulated and clear regulations and procedures governing public offering of securities including tender offers should be prepared and enforced. The MC should have clear responsibility for the control of public as well as private offering, sale, and distribution of securities. Rules governing mergers and acquisitions are not in place and need to be well defined. Corporate governance principles need to be fully addressed with respect to the company act as well as current laws governing the securities market. Minority shareholder protection, mergers and acquisitions, and tender offers are issues that need to be governed and organized by clear rules and regulations as well as detailed procedures. Issues of fair and equal treatment of all shareholders need to be clearly defined.

- In current practice, many of the law enforcement agencies (MC, CBK, and MOCI) rely on external auditors more than inspection to monitor compliance by supervised institutions. To ensure the quality of the auditing and particularly the audits of financial intermediaries and listed companies, and pending the amendments of the legal framework, it is suggested that the MC administer and maintain a list of auditors who meet the eligibility criteria developed by the MC.

35. Investment fund regulation

- Regulation and supervision of CISs are segmented among three agencies. Maintaining the integrity of the industry requires detailed and comprehensive rules and regulations and should be supervised and monitored at all stages by the regulating

agency. Owners, founders, operators, and managers need to be subject to strict fit and proper assessments. Auditors of these funds should be selected from a list of auditors who meet the eligibility criteria to be developed by the regulating agency, which will also administer and maintain such a list. A set of rules and regulations that provide for the full protection of investors needs to be in place and strictly enforced. It is recommended that the regulating agency develop and issue investment performance standards similar to those of the Association for Investment Management and Research (AIMR) of the United States.

- Prudential rules are also required to ensure the solvency of the fund and that its assets are well diversified. The law should develop guidelines and prudential rules regarding the investment policy to be announced and followed by the fund. Such a policy should insure sufficient diversification of assets. The classification of mutual funds by categories, reflecting different investment strategies, needs to be clearly defined to help investors evaluate the risk of their investments.

- There are no clear rules governing a fund's net asset value (NAV) calculation. The rules do not require the funds to include in their prospectuses the methodology they intend to use. It is not clear at present how NAV is calculated, what methodology is used, the frequency of calculation, and whether such a methodology requires prior approval by the regulating agency. In addition, there are no rules mandating the publication of the NAV on a daily or at least a weekly basis. It is also not clear how market prices of stocks are used in calculating NAV of the portfolio of the fund (are they average market prices during a trading week or the closing price of the day of calculation or price of the last day of the trading week). This process is only specified in general terms by the Articles of Association of the fund on the day it is licensed, a provision that seems unfair to investors. Neither the MC nor the CBK are authorized to set the parameters of NAV calculation or its frequency, nor are they empowered to issue detailed guidelines concerning CISs' other related issues. This industry is growing fast, circumstances are rapidly changing, and the regulating agency should be empowered to keep up with changing market requirements. Small investors should be afforded full protection.

- The CBK is the regulating agency designated to monitor, supervise, and inspect CISs. Supervision is usually done by external auditors appointed by the CBK. Inspection in some instances is done by auditors due to shortage of staff. Training should be organized in order to insure that inspection teams are knowledgeable and experienced. In addition, the CISs should be licensed, regulated, and monitored within the wider context of securities market functions, regulation, and monitoring.

36. Market intermediary regulation

- Entry standards for market intermediaries need to be redefined for each type of service. Prudential rules and regulations need to be in place for all types of intermediaries from incorporation to liquidation.

- Licensed intermediaries are under the oversight of, and inspection by, different regulating agencies, which may not be using a consistent approach.

- Rules and regulations should be supplemented by a code of ethics for each type of intermediary. Any company rendering intermediary service should be required to establish clear internal procedures in full compliance with rules and regulations and indicating the company's market practice and how it is applied and monitored. The intermediary must avoid conflict of interest and should inform clients of any conflict of interest that may arise.

- A compliance officer must be appointed for each intermediary to ensure that the rules are abided by.

- The MC, being the regulating agency at present, should be empowered to inspect the books, records and business operations of all intermediaries. Inspections should be carried out on a regular basis, at least once a year. It should be empowered to impose necessary and relevant sanctions that would provide full protection to clients.

- It is desirable that the plan of the KSE to establish an IPF be implemented to provide investor protection in case of bankruptcy of the financial firm. All financial intermediaries should contribute to the fund based on their revenues from securities activities. In addition, criteria for capital adequacy and solvency should be established and closely supervised and monitored by the regulating agency.

37. Secondary market regulation

- The MC and the KSE should be separate institutions, each with its own resources and staff, as well as separate management. This arrangement would avoid conflict of authorities, mandates, interests, and functions, and would enhance the credibility of supervision.

- The MC should be empowered to perform regular on-site inspections to ensure the reliability of the arrangements made by the KSE for monitoring and supervising the trading system. It should also be empowered explicitly by law to license the KSE(s).

- The nonprohibition of insider trading is a serious defect. The KSE will not be able to maintain the fairness and integrity of the market in absence of necessary rules and regulations as well as a system to deter and detect unlawful and fraudulent practices.

- Although the surveillance system seems adequate for the present level of trading, the KSE should be able to implement a wider and more severe set of sanctions, including levying fines.

- In order to exercise proper risk management, the system developed by the KCC should require ultimate dematerialization of outstanding securities and become fully automated on the basis of book entries. This requires an amendment to the current law; otherwise investors cannot be compelled to allow total immobilization and dematerialization. The KSE is authorized to supervise the KCC, but there is no formalized system in place.

- In order to improve the clearing and settlement systems, dematerialization of securities needs a strong legal basis to ensure the effectiveness of the risk management system. Weaknesses in the supervision of clearing, settlement and depository systems may cause high risk. The KCC inspection by the KSE needs to be strengthened as the potential risks these institutions pose to the financial system are high. Serious attention must be given to supervision of the clearing and settlement systems and to addressing the conflicts of interest that arise as a result of the governance structure of the MC, the KSE, and the KCC.

G. Principle-by-Principle Assessment

38. The implementation of the IOSCO objectives and principles of securities regulation by the MC in Kuwait was assessed based on existing laws, regulations, and practices. Information was obtained from various reports, publications, and from interviews with market authorities and institutions.

39. A principle will be considered to be **fully implemented** whenever all assessment criteria are generally met without any material deficiencies.

40. A principle will be considered to be **broadly implemented** whenever the ability of the jurisdiction to provide affirmative responses to applicable key questions are limited to the questions excepted under the benchmark and such exceptions do not substantially affect the overall adequacy of the regulation that the principle is intended to address.

41. A principle will be considered **partly implemented** whenever the assessment criteria specified under the relevant benchmark for that principle are generally met without any significant deficiencies.

42. A principle will be considered **not implemented** whenever major and material shortcomings are found in adhering with the assessment criteria.

43. Whenever a system is assessed to be broadly, partly or not implemented with respect to a particular principle, recommendations should be proposed for achieving full implementation.

44. A principle will be considered **not applicable** whenever it does not apply given the nature of the securities market and relevant structural, legal and institutional considerations.

Table 1. Kuwait: Detailed Assessment of Observance of the IOSCO Objectives and Principles of Securities Regulation

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	The Kuwait securities market is governed by several laws and regulated by more than one regulatory authority. The main law governing the market is the Amiri Decree (August 1983). It sets the objectives of the MC, which is the market commission, and the KSE, their functions and responsibilities. The decree and its executive regulations provide the main legislative framework governing the market and part of the industry. The MC and the KSE is one body responsible for the enforcement of this law and regulations. According to the law (Article 4), the MC has the following objectives: (1) develop the securities market in the best interest of economic development and assist in the realization of state economic policy objectives as well as the development of dealing techniques in the market with a view to protecting the investors; (2) develop relations with other foreign markets and use their experience for the speedy development of the securities market in Kuwait. The powers and authorities of MC according to this law (Article 6) are defined as follows: (i) set out trading rules on the floor of the stock exchange, oversee its application and supervise transactions; (ii) take necessary actions against suspected transactions in accordance with the governing rules; (3) approve membership applications of brokers as well as the listing of securities issued by Kuwaiti joint stock companies; (4) suspend temporarily the trading of one or more of the stocks or the whole market in case of emergency; and (5) approve the budget and financial statements of KSE and the assignment of external auditors. The KSE is generally responsible for supervision and regulation of securities trading and the prudential regulation of trading and for part of market intermediaries (only the Securities Brokers and Securities Clearing and Depository). Other intermediaries are subject to the regulation and supervision by different agencies, namely the MOCI, and the CBK. The MC and the KSE are almost one body under the same management with dual function and responsibility (one is of the KSE and the other is of the market commission). Articles 3 and 6 of the decree define the responsibilities of the agency in these two capacities. The MC/KSE is managed by a committee under the chairmanship of the MOCI and membership of the general manager of the market who is the deputy chairman of the committee, one representative from each of the CBK and MOF, two experts, and four members nominated by the chamber of commerce and industry including one of the brokers. The CBK is a member of the Board of KSE by virtue of law and this is the only formal arrangement in place. There are no similar arrangements between the different regulating agencies or between components of the financial system. There is no legal protection of the MC/KSE staff acting in the discharge of their present functions and powers. Any action against the MC/KSE is directed to the authority and not to its staff.
Assessment	Not implemented.
Comments	The responsibilities of MC, which is the designated regulator by law, are not clearly defined.

	They are defined in very general and broad terms and thus it was difficult to set out the relevant executive regulations. This has caused a gap between MC responsibilities and authorities. The power and jurisdiction of the regulator is limited and not objectively stated as it is confined only to the supervision of part of the market (KSE and member brokers). The absence of legal protection of the staff of the regulator in the discharge of their functions may cause, to a certain extent, that the interpretative process of legal provisions into rules and regulations is not transparent. There is a clear imbalance between the powers of the regulator and his responsibilities. The organizational structure of MC does not even permit it to fulfill its assigned duties and responsibilities. The regulator and the KSE are merged together in one body under one management and with one organizational structure. This may affect the supervisory role of the commission over the KSE and weakens the ability of the regulator to enforce the law in a consistent manner. No inspection has ever been carried out by the MC over the KSE. There is no plan for this purpose in place. The MC has no technical staff and it relies on the staff of the KSE. The system under the circumstances does not guarantee the prevention of possible conflict of interest or abuse of discretion. Division of responsibility between regulating agencies does not avoid inequities and leaves gaps. The various laws that govern the market are not fully coherent and do not form a comprehensive legal framework. For example, the primary market is the concern of the Company Department (CD) at MOCI that examines only the legal side of the company's incorporation and at the issuance of capital shares, whether publicly offered or privately placed. The MC/KSE is concerned with trading on the secondary market, while the CBK is concerned with investment companies including investment funds. Other intermediaries in the market are not clearly governed by relevant rules or regulations. Each component of the market is regulated in isolation of the others. The law enforcement powers of the regulating agencies are not clearly defined. Coordination and cooperation between the regulating agencies are not formalized and there are no legal procedures in this respect. This may cause significant limitations.
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and exercise of his powers.
Description	The MC/KSE is granted an independent status by law (AD Article 1). The market is regulated by a committee under the chair of the MOCI (MC—AD Article 5), which is appointed by the Cabinet for a term of three years renewable. The general manager of the KSE is appointed also as the deputy chairman on a full time basis for a term of four years renewable by a cabinet decree. The KSE reports to the minister and is directly responsible to him and not to the ministry, its departments, or its staff. The minister is fully involved in the KSE's decision-making process. In addition to the chairman and deputy chairman/general manager, the committee is composed of eight members who are appointed by the Cabinet on the suggestion of the MOCI, for a three-year term that is renewable (AM D Article 5). The eight members are a representative of the MOF, a representative of the CBK, two experts proposed by the minister and four members chosen by the Chamber of Commerce and Industry including one stock broker. The MC is the governing body and is empowered by law to carry out the following functions: (1) setting the rules for securities trading and its surveillance and supervision; (2) taking necessary actions regarding unlawful securities transactions in conformity with the by-laws; (3) examining the applications of stock brokers and the listing of shares and other securities on the KSE; (4) suspending trading in case of contingent circumstances causing a threat to the market; and (5) approving the KSE annual budget and financial statements and appointing of auditors. The MC/KSE is financially independent and does not rely on any allocation from the government, but only on its own resources. It is accountable to the Cabinet of Ministers,

	through the MOCI who is required by law (AD Article 7) to submit quarterly reports to the Cabinet. The agency is also accountable to the Parliament to respond through the minister to issues related to the securities market. The MC/KSE publishes its annual report to the public. However, the report does not contain the authority's financial statements. The legal framework does not stipulate how market participants can contest the MC/KSE's decisions.
Assessment	Not implemented.
Comments	While the law grants the independence of the MC/KSE, it is not, in practice, operationally independent from external political or commercial interference in the exercise of its function. On the one side, the minister is the chairman of the committee and this might create a political or policy conflict. On the other side, six members of the committee represent the market players and business community and thus create an obvious conflict of interest. The membership of a stock broker may give him an advantage over others and this is against the fairness of the agency vis-à-vis licensed intermediaries. For improved transparency, it is suggested that the MC/KSE's financial statement be published in the annual report.
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	The MC is empowered to regulate and supervise the KSE and set the rules governing securities trading and the exchange operations. The law does not clearly empower the commission to license and inspect the KSE or to impose sanctions. The current practice is that the Internal Auditing Department reports directly to the MC on the operations of the exchange. The deputy chairman of the MC is the general manager of the exchange. In addition, brokerage firms are partly regulated by the commission in the sense that they are licensed by MOCI and supervised by the commission in as far as their trading function on the KSE is concerned. Other securities intermediaries are licensed and supervised by different regulators. In the case of issuers, while approving new issues of securities is the responsibility of the MOCI, the KSE controls disclosure requirements of listed companies including the prospectus approval. The KSE is empowered to apply administrative sanctions on brokers as well as listed companies on the Exchange (AD Article 14). In case of brokers, sanctions include (i) an admonition, suspending the activities of the company for a period not to exceed 4 months; and (ii) confiscation of bank guarantee and canceling KSE membership. In case of listed companies, these sanctions are the suspension of trading on company's securities for a period not to exceed 4 months and delisting. No pecuniary sanctions are permitted by law. The resources of the KSE are defined by law (AD Article 12) which stipulates the revenues of the agency shall be made up of (i) proceeds of services rendered by the KSE; (ii) returns on the KSE investments; (iii) proceeds of penalties imposed pursuant to the provisions of this law; (iv) fees levied; and (v) other revenues approved by the Board. The agency does not regularly rely on the government for budget support. The government may provide financial assistance to meet investment requirements (cost of the new trading system was totally covered by the government—approximately US$1 million). In general, the KSE has enough resources to discharge its present level of duties. The salary scale applied by the KSE is competitive with the private sector; and the turnover rate is low. The total number of current staff stands at 160; the majority is technical/professional staff with a university degree. Although training programs are conducted, the KSE may find difficulty to recruit additional staff particularly at the supervisory senior levels.

Assessment	Not implemented.
Comments	For its current mandate, the MC as a regulator does not have adequate powers and resources to perform its functions. The level of responsibility of the agency is beyond its capacity and power. Given its mixed structure with the KSE, the line of responsibility is confusing and unable to control the market. While MC is empowered to oversee the KSE and brokerage firms, it does not have explicit or clear power to license, inspect and investigate them. In addition, the sanctioning system that is currently applicable cannot keep the market in order and is a major drawback. The MC/KSE needs to be empowered with pecuniary sanctions and a larger spectrum of sanctions, which should tally with the seriousness of the irregularities committed by market participants. The law should be amended for this purpose and set ceilings on the amount of sanctions.
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	The law empowers the MC to set rules and executive decisions as required and as defined by specific provisions. The law addresses general issues and refers details to the executive regulations. For example, the law consists of 18 Articles. Articles 1, 3, 5, 6, 7, and 8 create the securities market and the KSE as an independent entity to discharge its responsibilities as defined by this law. Article 2 defines the type of securities to be issued or traded in the Kuwaiti market. Article 9 defines the responsibilities of the director of the market (actually means the KSE). Articles 13 and 14 create mechanisms for dispute resolution in terms of arbitration, as well as disciplinary sanctions for brokers and listed companies on the KSE. The law does not specifically and explicitly prohibit unlawful actions, market manipulation practices, or insider trading. It also does not organize the issuance of securities, their public offering, disclosure obligations and requirements and procedure for the safeguarding of shareholder rights and minority protection. The rules and procedures, which govern the KSE operations, transactions, listing of securities, are set by the executive regulations. The MC and the KSE have issued various executive decisions and resolutions implementing the executive regulations. The control process—procedure or inspection guidelines—are not formalized and publicized. Inspection guidelines for brokerage and other intermediaries as well as guidelines for controlling disclosure requirements of listed companies are not yet completed. Some of these regulations, procedures and guidelines are scattered in different instructions or administrative decisions, which in turn has no easy reference for users or target participants. Outcomes of investigations are not published or made available.
Assessment	Not implemented.
Comments	The regulatory process is not clear. Rules, procedures and decisions are not available to the public. There is no consolidated reference or guide for these rules or executive decisions that makes reference easy, either for the different users or for the staff of the KSE themselves. The law, its executive regulations, and executive decisions are not yet available on the KSE web site. The KSE is in the process of implementing a relevant plan for information dissemination and publicity, including updating the web site. The MC does not consult with industry, the affected parties or the public, as there is no rule of rule making in place. The process should be formalized. Moreover, a report on the outcome of the investigations or inquiries may be published to provide guidance to the market participants on problems that should be avoided.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.

Description	AD Article 69 prohibits violation of confidentiality. There is no code of ethics for the KSE personnel, although the staffs are prohibited from investing in the market except with prior approval, with a view to avoiding conflict of interest. Apart from an administrative instruction, no clear procedure is established in this respect.
Assessment	Not implemented.
Comments	To formalize rules and procedures related to confidentiality and dealing with conflicts of interest, an explicit ethics code applied to the KSE's personnel may be established. A compliance officer may be designated to ensure compliance of this code.
Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	At present, no market institution is a self-regulated entity in a proper sense. The law does not address this issue, and it does not specifically stipulate how the KSE is licensed. It does not empower the MC to regulate the licensing process for any of the intermediaries. It only provides some rules regarding the conditions to be met by brokerage firms. The director of the KSE is the deputy chairman of the MC. In this capacity and through him the KSE is supervised and controlled to ensure that it complies with the provisions of the law and the regulations. Under the present Law, the KSE as such has no law enforcement powers, no power to set the trading rules or any other rules governing the financial and administrative affairs. Technical departments of the KSE (also of the MC) propose to the MC through the KSE director, for final approval. The KSE has no Board of Directors but a director who is the deputy chairman of the regulating body (MC), and he has to get the approval of the MC on any decision related to the KSE. The KSE is considered a government body, albeit independent, and at present is the sole stock exchange in Kuwait. The KCC is a private company responsible for the clearing, settlement, and securities depository functions and supervised by the KSE. The KCC also manages the Settlement Guarantee Fund (SGF).
Assessment	Partly implemented.
Comments	KSE and KCC are the two institutions which should have a full SRO status. As the market gains maturity and experience, regulators envisage allowing for the implementation of the SRO principle.
Principle 7.	SROs should be subject to the oversight of the regulator, should observe standards of fairness and confidentiality when exercising powers, and delegated responsibilities.
Description	There are no SROs at present in a proper sense. Although the legal framework does not prohibit self regulation, it does not provide a set of clear rules for this purpose. While the stock exchange could have been recognized under the current legal framework as a self regulated agency, the present organizational structure and administrative system do not enable the implementation of such a principle. The MC, which is the market regulator, acts actually as the exchange's board of directors, thus defeating the principle of self-regulation. In the meantime, the Kuwait Clearing Company (KCC) is a self-regulated entity under the supervision and oversight of KSE, and is implicitly and indirectly subject to the oversight of the market regulating agency.
Assessment	Partly implemented.
Comments	The law should be amended to allow for SROs and clearly state that the regulator oversees and inspects the activities of self-regulated entities. The regulator should also be empowered to

	implement deterrent sanctions over SROs when established.
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	There are no rules regarding comprehensive inspection and investigation. Market participants come under the supervision of different agencies, namely the MC/KSE that supervises the KSE, the brokers and the Clearing House; the CBK, which supervises investment funds and portfolio managers; and the MOCI, which supervise the incorporation and licensing of all financial intermediaries. The KSE inspects brokerage companies and the Clearing House only in case of violating trading rules, as well as clearing, settlement and depository rules. No regular/routine inspection is conducted. Similarly, the CBK inspects investment funds and investment managers. The KSE and the CBK conduct investigations in case of violation of the law, its executive regulation and executive decrees. They can have access to any data and document of the investigated intermediaries. These entities are also required to provide those who are conducting the investigations with copies and abstracts of the documents as they may require. Staffs conducting the investigations are granted a judicial power in order to prove the actions committed in violation of the law, regulations and executive decrees. The investigating agency has no subpoena powers. The KSE has developed an online surveillance system to monitor transactions on the KSE. The objective is to detect fraud and manipulation. The present facilities and staff are adequate for the level of authority and type of actions.
Assessment	Partly implemented.
Comments	No comprehensive inspection procedures have been put in place or made available. No regular inspections are performed (at least once a year) and seek to measure the company's overall commitment to the rules and provisions of the law. Companies are notified in advance, as there is no unannounced inspection intended to investigate a specific incident or infraction. While staff can conduct investigations in case of violation of the law, its executive regulation and executive decrees, investigation is carried out by different agencies with no formal coordination. Inspection and investigation are not comprehensive processes; and they are not intended to measure the intermediary's overall commitment to rules and regulations. The regulator has no subpoena powers, and it cannot call witness, or any other party to complete its investigations. Although the KSE has developed a surveillance system to monitor transactions on the exchange, and it has the power to suspend trading or cancel transactions, no supervision through surveillance is conducted by the regulating agency over the KSE. The director reports to the MC on action taken by him or his designator, yet there is no established procedure for this purpose. He may use his discretion as to whether the case is worth reporting or not. The MC has no clear rules or procedures in this respect. In addition, the rules requiring record-keeping or retention by KSE or by other regulated entities are not sufficiently detailed. For example, the rules do not specify the type of records or for how long this information should be kept. There is no clear set of sanctions in case the KSE violates the rules. Similarly, there are no rules or procedures by other law enforcement agencies such as the CBK or MOCI regarding the inspection and investigation of their supervised entities or concerning the record-keeping process. Insider trading is neither prohibited nor penalized, and this is of serious concern to the investors

	and intermediaries. The present organizational structure of the KSE (which is the same as the structure of the regulatory agency) does not include a department or departments for inspections, investigations and control (or a general law enforcement).
Principle 9.	The regulator should have comprehensive enforcement powers.
Description	The different regulating agencies have the power in their respective domains to enforce the compliance with the provisions of law, rules, and regulations. The power includes the investigation, suspension, and revocation of license of the concerned company. The power also includes the suspension of trading offers and bids aiming at price manipulation and to cancel transactions in violation of the law. Transactions causing harm to the market or to market participants and investors could be cancelled. All sanctions are of administrative nature and as defined by law. The regulating agency has no power to impose or levy fines and cannot compel testimony, particularly from a third party. Cases of a criminal nature are referred to the prosecutor general. Enforcement power is based on results of surveillance, inspection and investigation. The regulating agency has limited power to enforce its rules.
Assessment	Partly implemented.
Comments	The enforcement powers are limited, not comprehensive, and they are segmented between different agencies. For example, while the KSE is empowered to inspect and investigate brokerage firms, it does not carry out this function on a routine basis. In addition, there are no clear procedures in place with a view to ensuring transparency in this respect. MC is empowered to supervise, inspect and investigate the KSE, but in practice it does not do that and it did not develop relevant and clear procedures for these purposes. Sanctions are administrative, and no fines can be levied on the supervised entities by any of the corresponding supervisory agencies. Thus the power to impose effective sanctions is limited. The market is segmented in terms of law enforcement powers and responsibilities. While a broker, for example, is subject to the licensing power of one agency, it is subject to the investigation and inspection power of a different agency. Other intermediaries are also supervised by a different agency than the one that licensed them. The problem is aggravated in the absence of sufficiently detailed rules and procedures.
Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	Enforcement power is based on results of surveillance, inspection, and investigation. The KSE and the CBK carry out inspection and investigation on cases of law violation by their respective regulated institutions. They rely on auditors' reports for this purpose. No regular/periodic inspection plan is in place or was made available. An on-line surveillance is carried out on trading activities by the KSE. Inspection results are immediately acted upon by the legal department of the KSE in order to take a proper law enforcement action.
Assessment	Partly implemented.
Comments	Enforcement powers should be used basically for the purpose of deterring unlawful actions. The regulator's ability to detect breaches of the law is marginal and limited. MC has not developed any surveillance capacity to oversee the stock exchange. As market regulator, it has no power to regulate most of the market participants. It regulates only the brokers and the stock exchange with limited power of penalization, that is, administrative sanctions and no fines. Investor protection requires precautionary measures as well as a wide spectrum of post-event sanctions. This principle should be on an equal footing with the use of powers to penalize those who

	violate the law. The regulatory agencies acting at present in Kuwait did not use their powers to ensure an effective and credible use of inspection, investigation, surveillance, and enforcement powers in an effective and credible manner. They are partly able to implement an effective compliance program, which can detect suspected breaches of the law and deter to the extent possible any unlawful actions.
Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	The law empowers the MC/KSE to establish links and relationships and to cooperate with other markets and institutions, whether domestic or foreign, with a view to developing the market, its trading activities, and the macroeconomic environment and related polices. No specific mention is made whether the MC/KSE should or would exchange information with other institutions or sister agencies domestically or internationally. The KSE shares public information and publishes annual reports, trading data, and information on regular basis. It also has a web site for the dissemination of trading information. The nonpublic information is shared with judicial and other law enforcement agencies as deemed necessary. However, the cooperation among authorities is not formalized, but consultation is frequent. A number of MoUs have been signed with regulating agencies (for example in Bahrain, Egypt, Jordan, and Tunisia) for cooperation, consultation, exchange of information, and other supervisory purposes. The agency has no experience yet with the exchange of nonpublic information with foreign counterparts.
Assessment	Partly implemented.
Comments	The law allows cooperation with other regulators and agencies. There is no provision in the law that specifically authorizes the MC/KSE to share nonpublic information with domestic and foreign counterparts. A provision to that effect should be promulgated in order to clearly authorize the regulator to share non-public or confidential information.
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	Nonpublic information sharing is currently practiced with domestic judicial bodies only and for a legal case. The authority receiving the information commits to maintain the confidentiality of that information. The mechanism for public information sharing is not formalized and is governed by agreement between the various local authorities and by MoUs with foreign authorities.
Assessment	Partly implemented.
Comments	Information sharing procedures and mechanisms need to be in place and should be formalized by way of MoUs. In addition, the MoUs, which have been signed by the MC/KSE, should be in line with IOSCO standards.
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.

Description	While the law allows the regulator to cooperate with sister agencies and market institutions, it does not allow for the exchange of nonpublic information with foreign regulators.
Assessment	Partly implemented.
Comments	The law should include a provision that explicitly and specifically allows public and non-public information sharing with other regulators. In pursuance of the signed MOUs with foreign regulating agencies, KSE is able to share only public domain information.
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	Neither the securities market law nor the executive regulations require that public offering of securities be made with a prospectus to be approved by the regulating agency. The Company Act also does not stipulate such a requirement. The use of a prospectus is only a listing requirement, which should be observed by companies seeking listing on the KSE. Publicly offered companies for the purpose of capital increase are listed after one year and they are required to prepare a prospectus for the review of the KSE with regard to its sufficiency and accuracy of the information included therein. The prospectus contains information mainly on the characteristics of the issuer and the issue, the company's activity, and a summary of audited financial statements for the last three years. Listed companies are required to disclose their financial information on quarterly basis. The annual report includes the report of the Board of Directors. Financial statements should be prepared on the basis of International Accounting Standards (IAS) and audited according to International Auditing Standards. The KSE examines the financial statements and notifies the company of its observations. Noncompliance with these requirements would lead to delisting of the company. Present human capacity seems insufficient to enable examination of all statements. The KSE should consider recruiting more staff that is qualified for this purpose. A stockholder of listed companies is required to disclose immediately to the KSE if his ownership reaches (directly or indirectly) 5 percent of company capital. Similarly, listed companies should disclose immediately names of shareholders whose ownership interest reaches 5 percent of its total shares. In addition, listed companies must disclose immediately to the KSE any material information that may affect their business or financial position. The KSE displays this information on trading screens instantly. Stockholders who violate these rules are denied the right to vote for the extra number of respective stocks, in two consecutive general assembly meetings. CISs as issuers of investment units are required also to comply with disclosure requirements.
Assessment	Partly implemented.
Comments	Public offering of securities needs to be fully organized and a set of well-articulated and clear regulations and procedures should be prepared and enforced. The regulating agency should have clear responsibility for the control of initial public offerings, public offerings as well as private placement, sale, and distribution of securities. The rules governing disclosure in the primary market are few and have significant shortcomings. However, law enforcement in the primary market is the responsibility of the CD under the Company Law while law enforcement of the secondary market is the responsibility of MC/KSE under the Securities Market Law. There is a great deal of inconsistency between the two laws with regard to disclosure requirements. The regulatory framework does not specify clear, timely and comprehensive disclosure requirements and is deficient with respect to the requirements that apply to initial

	public offerings, the content, and distribution of the prospectus and other offering documents. Current rules specify that publicly offered companies are required to file a prospectus with the stock exchange only when they apply for listing. There are no clear provisions requiring the submission and sanctioning of a prospectus by the regulator, the contents of the prospectus, the sale and distribution of securities, and the other aspects of public offering. Publicly offered companies for the purpose of capital increase are listed after one year of the offering date and are required to file a prospectus for the review of the KSE as part of the listing rules. This means that the securities are offered and sold to the public and may be traded outside the stock exchange for a full year without meeting clear requirements of disclosure that could be monitored by a regulating agency. The listing rules also specify the disclosure requirements with respect to the annual reports, periodic reports, and the immediate disclosure of any material information that affects the price of the listed securities. Generally, the prospectus contains little information, as it mainly covers the characteristics of the issuer and the issue, the company's activity and a summary of audited financial statements for the last three years. The rules do not specify the extent, the type, and the level of information details the prospectus should provide. In addition, there are no rules that govern advertising outside the required disclosure documents. In addition, selling and buying by any investor of significant amounts of stocks are not governed by a complete and comprehensive set of tender offer rules. The legal framework should address this issue. Rules governing mergers and acquisitions are not in place and need to be well defined.
Principle 15.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	The Company Law provides for shareholders' basic rights and obligations. Issuers and stockholders are required to disclose to the KSE and the CD the ownership position of major shareholders when shareholding reaches 5 percent of the company's capital. No tender offer rules and procedures are in place. It is not clear how mergers and acquisitions are governed and organized. There are no rules to protect minority rights.
Assessment	Partly implemented.
Comments	Corporate governance principles need to be fully addressed with respect to the Company Act as well as current laws governing the securities market. While the basic rights of shareholders are specified by various laws, they are not sufficient and have significant gaps. The shareholders have the right to document and transfer ownership, to participate in voting decisions, to participate in the distribution of benefits, to hold management accountable for its actions, etc. The quality of disclosed information and its timeliness, together with other aspects of rights that ensure shareholders equitable treatment, are not sufficiently specified or monitored by the different law enforcement agencies. While the secondary market through listing rules applies reasonable safeguards for fair and equitable treatment of shareholders, the primary market seriously lacks such safeguards, particularly the information necessary and material for informed decision-making. Minority shareholder protection, mergers and acquisitions, and tender offers are issues that need to be governed and organized by clear rules and regulations, as well as detailed procedures. Issues of fair and equal treatment of all shareholders require full revision and need to be comprehensively and clearly defined. The securities regulatory agency should be fully involved in this area of regulation and the relevant enforcement power should be provided.
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	Current regulations of the MOCI require that financial statements be prepared and audited in

	accordance with the International Accounting and Auditing Standards. All auditors are required to follow and adhere to international standards. Listed companies on the stock exchange are required to observe disclosure rules and to submit audited financial statements and annual reports. Compliance is enforced and monitored by KSE. The Company Act and the MOCI control and regulate the accounting and auditing profession and the establishment of standards.
Assessment	Partly implemented.
Comments	It is the current practice that the law enforcement agencies (MC, CBK, and MOCI) rely on external auditors more than inspection to monitor law compliance by supervised institutions. Although the application of accounting and auditing standards is a legal requirement, there are no adequate set of rules and regulations as well as procedures to monitor compliance by the supervised entities and the profession. A serious legal deficiency is that publicly offered companies are only monitored by KSE at the time of listing, which is one year after the date of offering and sale of securities. To ensure the quality of the auditing and particularly the audits of financial intermediaries and listed companies, and pending the amendments of the legal framework, it is suggested that MC administer and maintain a list of auditors who meet the eligibility criteria developed by the MC. Such criteria would ensure to great extent auditors independence.
Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	Law No. 31 of 1990 and Ministerial Decree No. 113 of 1992 govern the establishment and operation of CISs and set standards for their licensing, including managers of these funds. The CD of the MOCI is the administrative body that enforces relevant laws and is responsible for the licensing of CISs if approved by the CBK, and their compliance with related legal provisions. Two types of funds are allowed by Law: (1) open-end funds with variable capital; and (2) closed-end funds with fixed capital. Funds issue units or certificates as their financial tools, which should be listed on the KSE for trading. The investment funds must be established by a joint-stock company, and their capital paid in cash. Funds are not allowed to carry out any banking activities, particularly lending or guaranteeing any third party, or activities related to currency or bullion speculation. The applicable criteria for eligibility to operate a CIS include fit and proper, honesty and integrity, competence to carry out the functions and duties of a scheme, the financial and technical capacity to discharge specific powers and duties, and adequacy of internal management procedures. The key individuals who are employed by the intermediaries for the marketing or operation of the CIS should meet the following conditions (Law Article 21): • Educational requirements: University degree with three years experience, or alternatively five years experience. • Fit and proper. • Honesty and integrity.

	• Experience. It is prohibited to operate a fund without a license. Violation of the law in this respect is subject to the following sanctions: • Warning. • Replacement of the operator or the trustees. • Fund liquidation. The operator of a CIS must report to the regulatory authority on a regular basis (quarterly) his financial position. An annual and semi annual report is required to be published in the newspaper and disclosed to investors and must include financial information and information on any material changes (Law Articles 68–87). Such changes should be approved by the regulating agency. There are provisions to prohibit or restrict certain conduct likely to give rise to conflicts of interests between a CIS and its operator or their Associates or connected parties. Article No. 75 states that the fund trustee must carefully monitor the fund manager to prevent or inform the regulatory authority of any illegal events or conflict of interests between the fund and its manager. No cases of conflict of interest were reported as a result of inspection. Unless reported by third party, it seems that the regulating agency would not be able to detect cases. The regulator has full authority to prohibit or review any transactions that may involve conflict of interest. All related parties, either the operator or the trustee, or external auditors, must comply with conflict of interest prohibition between or among any of them. The fund must be managed by professionals who should meet conditions of competence and experience as well as integrity. Fund management should have an investment stake (minimum 5 percent of units) in the fund. Management is monitored by independent trustees who are appointed by the fund to safeguard investors. In addition, and for this purpose, the fund is reviewed regularly by external auditors and is subject to inspection by the CBK (Law Articles 75–81 and 89). The principal areas of inspection are (1) maintenance of a control environment; (2) compliance with applicable legal and regulatory requirements; and (3) compliance with internal control policies and procedures. The external auditors are required to report to the regulatory authority any irregularities regarding accounts, policies, and procedures, and instances of non-compliance (Articles 81, 82, and 83).
Assessment	Partly implemented.
Comments	The regulation and supervision of CISs are segmented and scattered between three agencies. The organization of this industry should be seen within the context of a securities market plan. Maintaining the integrity of the industry requires detailed and more comprehensive rules and regulations, and should be supervised and monitored at all stages from establishment to liquidation, by the agency concerned with the securities market at large. Owners, founders, operators, and managers need to be subject to strict fit and proper assessments. Auditors of these funds should be selected and appointed according to an eligibility criterion to be developed by the regulating agency. A set of rules and regulations that

	provide for the full protection of investors need to be in place and strictly enforced. It is recommended that the regulating agency develop and issue Investment Performance Standards similar to those of the AIMR of the United States. This area of regulatory supervision should be considered as possibly relevant for development of an SRO.
Principle 18.	The regulatory system should provide for rules governing the legal form and structure of CISs and the segregation and protection of client assets.
Description	The CISs can only be established by Kuwaiti joint-stock companies, which are incorporated for investment purposes as one of its objectives. A license is granted by the CD after approval by the CBK. A CIS is controlled by an independent trustee and managed by professional management from within the establishing company or externally hired by this company. The responsibilities of the trustee are (1) monitoring the CIS operator; (2) complying with all parties on conflicts of interest criteria; (3) ensuring that the operator is following the approved policy and procedure; and (4) informing the authority of any illegal or irregular actions. Article 73 stipulates that the investment trustee must be efficient and has the ability to monitor the CIS and make sure that the operator will safely manage the fund within the law standards and rules. Assets of the funds must be kept in a bank under the control of a trustee. Funds are required to be audited by external auditors approved by the supervisory agency. The CIS management is required to keep records in relation to transactions involving CIS assets and units (Law Articles 62, 69, 70, and 72). A register will be maintained for holders of units in the scheme. Both the management and the trustee are responsible for maintaining a record of investor transactions and both will be monitored and inspected by the regulatory authority (Article 72). The external auditor is required to report on any violation of the law and on irregularities or noncompliance events (Article 83).
Assessment	Partly implemented.
Comments	Rules need to be in place to require the manager of the fund to manage the fund's assets with utmost care and diligence; protect the fund's interest in each transaction, act, or disposition including all necessary caution and hedging to market risks; diversify the investments; and avoid any conflict of interest between holders of investment certificates, the fund's company shareholders, and those affiliated with the fund. Prudential rules are also required to ensure the solvency of the fund and that its assets are well diversified. The law should develop guidelines and prudential rules regarding the investment policy to be announced and strictly followed by the fund. Such a policy should ensure diversification of assets by setting limits on investments in the securities of a single company and in the certificates issued by other investment funds. In the absence of such rules, investors might be exposed to high investment risks. The prospectus used for the sale of the fund should clearly reflect the investment policy with a view to ensuring that client assets are protected. This would also enable the regulating agency to monitor compliance by the management. As indicated under Principle 17, it is recommended that the regulating agency develop and issue Investment Performance Standards similar to those of the U.S. AIMR.
Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	The CISs are required to file with (MOCI) a prospectus whose content is set by Executive Regulations of Law 31/1990 (Article 40 of Ex. Regs) and which must contain basic information

	on the fund such as remuneration of the investment manager, trustee, and other charges; the procedure for redeeming investment units or certificates; the valuation of assets; the regular disclosure requirements; a description of the investment policy and the dividend distribution policy; name and duration of the fund; investment objectives; paid capital and number of units with par value. The prospectus, once approved by CD, could be published and distributed to investors for the offering and sale of fund units or certificates. The regulating agency (MOCI) has the power to hold back an offering of a CIS if the documentation is not satisfactory. The CISs are subject to the same disclosure requirements as listed companies: annual (within 45 days), semi-annual (within 30 days), and quarterly reports (including the financial statements). The funds should be audited by one auditor or more. Quarterly reports are made available to investors of the fund and may be published if the regulating agency so decides (Ex. Regs. Article 68). The CISs are also required to adhere to immediate disclosure requirements on significant and material events (Article 69).
Assessment	Partly implemented.
Comments	The classification of mutual funds by categories, reflecting different investment strategies (equity, fixed income, money market, mixed) is not clearly defined. To better help investors evaluate the risk of their investments, it is suggested that such categories should be clearly defined. It is also recommended to publish the prospectus issued by the fund, once it is approved by the regulating agency in two daily newspapers. The risk associated with investing in funds should be highlighted by adding a disclaimer stating, "due to possible risk the value of the investment may decrease." This would provide protection to small individual investors.
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	Executive Regulations Article 78 of Law 31, issued by the Ministerial Decree No.113 of 1992, stipulate that the investment trustee must make a frequent evaluation of the fund units/certificates. The evaluation must be accurate, actual and in the manner and time specified. Articles 58 through 61 specify the manner and procedure of pricing of units/certificates of a CIS. The investor has the right to redeem his units/certificates directly from the fund if the Articles of Association of the fund so state. The fund will disclose the manner and timing of redemption. The investment trustee is responsible for calculating the share of the redeemed units in the NAV of the fund as well as for evaluating the price of units, which new investors wish to buy. This information must be published in at least two newspapers. Redemption will be based upon the published price. The trustee may nominate another entity to do this process after the approval of the regulating agency. Articles of Association of the fund will define the frequency (monthly, quarterly, semiannually, or annually) of asset valuation and pricing of units either for purchase or for redemption. There are no rules regarding a minimum time of the payout of redeemed proceeds. In addition, there are no rules or mechanisms for pricing controls (such as regular reconciliation and periodic audit) to identify and rectify any errors or misplacement of assets. Rules require that if the difference between units redeemed and units purchased is more than 10 percent of fund's issued capital at the time specified for redemption or purchase, the Manager of the fund can reject redemption after approval by the regulating agency unless otherwise granted this right by the Articles of Association. No rules empower the regulatory authority to demand, delay, or stop the deferral or suspension of redemption rights.

Assessment	Partly implemented.
Comments	It is not clear how the NAV should be calculated, what system is envisaged, and whether such a system should be approved by the regulating agency. It is also not clear if the market price of securities in the portfolio of the fund is used in calculation and how. No rules require or mandate the publication of the NAV on a daily or at least a weekly basis. This process is only organized by the Articles of Association of the fund on the day it is licensed, a provision that seems unfair to investors. Neither the MC nor the CBK are authorized to set the parameters of NAV calculation or its frequency, nor are they empowered to issue detailed guidelines concerning CISs other related issues. This industry is growing fast, circumstances are changing, and the regulating agency should be empowered to address changing market requirements. Small investors should be provided full protection. The CBK is the regulating agency defined by law to monitor, supervise and inspect CISs. The inspection teams need to be knowledgeable and experienced in securities markets, industry, and business. In addition, CISs should be monitored within the wider context of securities market regulation and monitoring. There are no rules governing listed funds, which are traded on the KSE, their valuation or other relevant issues.
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	Market intermediaries are incorporated and licensed by the CD of the MOCI. Except for brokerage and investment schemes that should meet special licensing requirements and conditions, other types of intermediation are not defined by the current rules and regulations. While investment schemes and brokerage are established for a sole purpose, others could be established to engage in multiple activities. Licensing is based on a capital requirement, appropriate knowledge, specified skills, and technical qualifications to conduct the business. Certification examinations by the regulating agency(s) are not required. The requirements for licensing as an intermediary are published in the official gazette and are publicly available. The brokerage firm should meet the minimum paid-up capital requirement, which shall not be less than KD 100,000. The company shall provide a valid bank guarantee (KD 50,000) as required by the MC. The applicant is licensed by the MOCI, which consults with the MC. The licensing authority requires that individuals associated with a licensed intermediary be licensed too. If a market intermediary fails to meet ongoing requirements, it shall be suspended or—in some cases of serious law violation—the license may be revoked. Intermediaries are required to give notice to the licensing authority in case of: • Significant change in the ownership of the firm. • Change in the senior managers or directors. • Change in the information delivered to the licensing authority during the licensing process or a material change such as change in capital for example. All of the above changes require the approval or nonobjection of the licensing authority before the change becomes effective.

	Information about licensed brokers is publicly available to investors by the KSE by various means. The licensing authority has the power of license denial in case of applicant failure to meet minimum entry conditions. The authority may use its discretionary power in this respect. A rejected applicant cannot renew his application except after one year.
Assessment	Partly implemented.
Comments	Entry standards for market intermediaries need to be redefined and made in a clear and detailed manner for each type of service. Prudential rules and regulations need to be in place regarding all types of intermediaries from incorporation to liquidation. Regular inspection needs to be planned and implemented in order to assess in a comprehensive manner whether entry standards are met on an ongoing basis.
Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	Only brokers and investment funds are required to meet initial capital requirements. According to Article (2), items (c) and (d) of the ministerial decree governing registration of brokers and assistant brokers; the company's paid–up capital shall not be less than KD 100,000; and the company should provide a valid bank guarantee covering the amount to be defined by the KSE (currently KD 50,000). The purpose is to avoid systemic risk, and allow orderly liquidation to ensure that the firm has sufficient liquid assets to meet ongoing liabilities as they come due. The rules do not cover the maintenance of on-going capital; however, the bank guarantee is the criterion for this purpose. The bank guarantee shall remain valid in full. If the value of the said guarantee is reduced for any reason, the broker shall top it up within the period specified by the KSE. The KSE may suspend the broker from dealing during such a period. Closed-end funds (those with fixed capital) are required to observe a capital requirement of KD 5 million. This amount is the minimum capital in case of open-ended funds (those with variable capital). Other prudential requirements for these two types of intermediaries include reporting to their respective regulating agencies (the MC in case of brokers and the CBK in case of CISs) their audited financial information and their annual reports and other information or data required.
Assessment	Partly implemented.
Comments	Prudential requirements are few and are imposed only on two types of intermediaries. Other types are not well defined and are not required to meet specific requirements or governed by relevant prudential rules and regulations. Presently licensed intermediaries are under the oversight of, and inspected by different regulating agencies, which may not adopt the same supervisory approach.
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
Description	There is no set of rules requiring market intermediaries to comply with standards for internal organization and operational conduct. The present rules specify a number of prohibitions that these entities (specifically brokers and investment funds) should observe. In addition, no code of ethics for any type of intermediation is in place.

	Brokers Article 6 of AD of 8 August 1984 regarding the admission of Brokers to the KSE stipulates that the broker's representatives and broker-assistant shall comply with the following: • Abiding by the provisions regulating the activities of KSE, its executive regulations, as well as all resolutions and instructions issued by the KSE. • Strictly observing that all transactions are executed on the floor of the KSE during working sessions and refraining from practicing brokerage business outside the floor or during non-official working hours. • Refraining from carrying out any business that may affect the reputation of the KSE, its members or dealers. Also, a broker's representative: • May not conclude any deal for his own account or for the account of the company represented by him, except through another broker and in accordance with the conditions stipulated by the KSE. • May not conduct any business that may conflict with his duties as a broker's representative who is responsible for executing securities transaction in the best interest of his client, based on the information available to him. • May not divulge any confidential information he possesses by virtue of his work. • May not publish any comments or opinions relating to securities and their trends in any manner. • Shall exert necessary efforts to cooperate with all brokers for the best interest of the KSE and the trading system. • Shall refrain from carrying out any work that may result in fictitious or artificial transactions. **Investment funds and investment managers** According to provisions of the Amiri Decrees No. 31 of 1990 and No. 113 of 1992 regulating CISs, operators of CISs are required to observe criteria for eligibility that include fit and proper, honesty and integrity, competence to carry out the functions and duties of a scheme operator, human and technical resources, and adequacy of internal management procedures. There are provisions prohibiting certain conduct likely to give rise to conflict of interest between parties (CIS and its operator or their associates or affiliates). CIS assets should be separated from the assets of management. The investor's money should be deposited in a bank under the supervision of the trustee. In addition, the investment trustee should not perform any investment functions. Current laws define no other market intermediaries.
Assessment	Partly implemented.
Comments	Detailed prudential rules and regulations are needed to govern market intermediation of all types. These rules and regulations should be supplemented by a code of ethics for each type of intermediary. Any company rendering intermediary service should be required to establish clear internal procedures in full compliance with rules and regulations and indicating the company's

	market practice and how it should be complied with and monitored. This procedure should include operational control measures such as the maintenance of books and other records, segregation of key duties, recording of all correspondence with clients, etc. The intermediary must avoid situations of conflict of interest and should inform his client of any situation of conflict of interest that may arise. A compliance officer must be appointed for each intermediary to ensure that these are abided by. The MC, being the regulating agency at present, should be empowered to inspect the books, records, and business operations of all intermediaries. Inspections should be carried out on a regular basis, at least once a year. The MC should be empowered to impose necessary and relevant sanctions that would provide full protection to clients.
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	The bank guarantees paid by brokers and the SGF are at present the only established system to minimize damage and loss to investors and to contain systemic risk. The SGF ensures the delivery-versus-payment principle on a T+3 settlement. It is envisaged by the KSE that an IPF be established to protect investors from the loss of cash or securities resulting from the insolvency or bankruptcy of a securities intermediary. The IPF is not yet in place.
Assessment	Partly implemented.
Comments	An IPF needs to be established. All financial Intermediaries should contribute to the fund based on their revenues from securities activities. In addition, criteria for capital adequacy and solvency should be established and closely supervised and monitored by the regulating agency.
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	The KSE operations and systems are governed by AD of 14 August 1983 and its executive regulations issued by Ministerial Decree No. 35 for 1983. The law did not establish the KSE as it was in existence before this law, but provides a set of rules regarding its organization, operations and conduct. According to this law (Article 4), the KSE is supervised by the MC, which is empowered to approve the KSE internal rules, trading systems, and listing requirements as well as other operations. Trading rules are set by the KSE and approved by the MC. The MC also approves the entry of products into trading on the floor of the KSE (shares, bonds, units of investment funds). All transactions are executed through licensed brokers who are members of the exchange. Brokers have sole access to the trading system to execute orders on behalf of their clients. Furthermore, all brokers enjoy the same access and rights to the trading system. The KSE is responsible for monitoring the conduct of the brokers. The MC also oversees the admission process for brokers in order to insure the KSE admission decision complies with the rules and regulations. The rules and operating procedures related to the above-mentioned matters are available to market participants through the official gazette and will soon be on the KSE website.

Assessment	Partly implemented.
Comments	While present rules and regulations ensure the oversight and supervision of the regulating agency (MC) over the KSE, the organizational structure of the MC and the KSE being almost one agency under one management is a serious drawback. The two agencies should be separate institutions with their own resources and staff as well as separate management authorities. This arrangement would avoid conflict of authorities, mandates, interest, and functions, and would help to maintain credibility. In practice, MC supervises KSE, the applicable trading system and trades execution procedures by means of reporting by KSE management and not through surveillance, inspection, and information analysis. This may reduce the effectiveness of MC supervision. Similarly, the conduct of brokers on the floor of the exchange is not directly supervised by MC through surveillance, inspection, and information analysis. The reporting system followed by KSE remains the main tool of supervision by MC.
Principle 26.	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	The MC has no established structure or mechanism to supervise and carry out routine on-site inspections of the KSE. The management of the KSE is the day-to-day management of the regulating agency and is required to report to MC on any unlawful action detected by KSE. In addition, there is an internal auditing mechanism which reports directly to the MC on the operations of the exchange. However, any change in the trading rules needs to be approved by the regulator (MC).
Assessment	Partly implemented.
Comments	The present monitoring and supervision by MC is not sufficient to ensure compliance by the exchange with its trading rules and thus the integrity of the market. The MC should be empowered to perform on-site regular inspections to ensure the reliability of the arrangements made by the KSE for monitoring and supervising the trading system. It should also be empowered explicitly by law to license the KSE(s).
Principle 27.	Regulation should promote transparency of trading.
Description	The KSE has put in place an electronic trading system, which is rather sophisticated. Trading is fully automated and displays online and real time information to all brokers and investors. The KSE publishes daily and monthly trading bulletins with wider circulation. The daily bulletin includes the prices at which operations have been carried out during the session; the closing price of each security and the type and quantity of securities traded during day; and a comparison of the closing price of traded securities during the day with the last preceding closing price of these securities. The bulletin also provides the highest selling price and lowest buying price. The monthly bulletin mainly includes market trading aggregates and indicators, number of listed companies, value and volume of trading, and number of transactions. Forward trading information is also provided. Trading information is also displayed on the website of the KSE.
Assessment	Partly implemented.
Comments	The nonprohibition of insider trading is a serious defect in the current trading system and practices. The KSE will not be able to maintain the fairness and integrity of the market in the absence of necessary rules and regulations as well as a system to deter and detect unlawful and

	fraudulent practices.
Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	The law and executive regulations prohibit price manipulation and artificial transactions on the KSE. There is no provision that prohibits insider trading. The KSE has established an online surveillance system that is fully automated to monitor trading. The director of the exchange is authorized to take necessary sanctions against deceptive transactions and then report to the MC.
Assessment	Partly implemented.
Comments	Although the surveillance system seems adequate for the present level of trading, the KSE should be able to implement a wider and more severe set of sanctions including levying fines. In the absence of surveillance by the MC, transactions on the stock exchange are not properly monitored. MC did not put in place adequate arrangements in order to be able to detect and deter fraudulent or deceptive conduct and improper trades. MC depends on reporting by KSE management for oversight and supervision purposes. In addition, it depends on the Internal Auditing Department, which reports directly to the MC on the operations of the exchange. The cases that have been reported are not based on a continuous or routine collection and analysis of trading information, but rather in response to cases of law violation detected by KSE. Insider trading should be prohibited and heavily penalized. The law should be amended for this purpose.
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.
Description	The present clearing and settlement system limits the risks of large exposure. In addition, a SGF to ensure a delivery versus payment (DVP) system with a T+3 settlement has been established.
Assessment	Partly implemented.
Comments	Securities traders in Kuwait are allowed to open accounts in the CSD system, which is managed by KCC. These accounts are also used to trade in the KSE trading system. One beneficial owner is allowed to open one account only. Brokers act as agents and take full responsibility for the performance of their clients. There are only 13 brokers, who are not allowed to perform proprietary trades. In order to avoid risks of a broker default, market rules require that the investor pay for a buy trade directly to the CSD, while the CSD initiates a payment on a sale trade that it paid in the name of the investor. Thus, cash is transacted between the CSD account and the investors' accounts. The KSE has a surveillance mechanism through which trading activities are monitored to detect any unusual activities. To better control market volatility in a given day, each security has its own market up/down limit. Once the limit is reached, a security cannot be traded further during that day. Investors can keep the custody of their securities as there is no regulation requiring compulsory depositing into the system However, investors cannot sell their securities unless they deliver their securities to KCC. The system is working efficiently and no real cash default has been experienced. The drawback is the risk of insolvency or bankruptcy of brokers. The MC/KSE should develop criteria for capital adequacy and solvency of intermediaries and establish an IPF for this purpose to which all intermediaries are required to contribute based on their revenues from securities-related activities.
Principle 30.	Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective, and efficient and that they reduce systemic risk.

Description	The clearing settlement entity, KCC works under the umbrella of the KSE as their Central Clearing and Settlement Agent. The KSE regulates KCC and the brokers. As a guarantee, each broker deposits KD 50,000 with the KSE (in the form of bank guarantee). Brokers act as agents, all trades settle gross directly between investors, thus reducing systemic risk in the market. The KCC safe-keeps securities in dematerialized form. Even though safekeeping of securities with KCC is optional, settlement through KCC is mandatory, and all settlements are done electronically by transferring assets between investors' accounts held within the KCC system. Large penalties are imposed on investors if they fail to meet obligations on the settlement date. Brokers are responsible for the performance of trades by their clients. The KCC manages the transfer of securities transactions ownership through book entry and of pledge of securities ownership. The present law and by-laws govern the clearance and settlement functions, which are carried out on the basis of a cash system and in a T+3 settlement period. Transfer of ownership occurs at settlement date, yet investors can sell what they bought at any time. There are automated links between the trading system and the settlement system. About 50 percent of outstanding shares are immobilized in KCC; others are still in the hands of their owners (mostly individuals). There is no legal obligation to keep the shares in the depository. Investors can, if they wish, keep them in their custody. The clearing and settlement process is safeguarded by a settlement guarantee funding mechanism. All brokerage firms are members of the SGF, which operates as an independent and separate entity within KCC. If a member fails to deliver cash or securities, the SGF meets their obligations. After drawing on the SGF, the member is required to reimburse the fund and pay additional fines based on a percentage of the value of the transaction. The KCC was entrusted by the KSE rules to establish a registration system for all investors in securities with a view to managing legal risks associated with securities ownership. In this respect, it is primarily responsible for the maintenance of records with names of owners of securities and the distribution of the entitlements of securities deposited with the KCC.
Assessment	Partly implemented.
Comments	The KSE is authorized to supervise KCC but there is no formalized system in place. The operation of KCC is not subject to direct inspection and regular review by MC. KSE monitors compliance by KCC, although no formal inspection was carried out and there is no plan for such inspections. It seems that KSE depends on reports by KCC. The clearing and settlement system is adequate and operates with no reported problems. The system is linked with the automated trading system of the stock exchange. For risk management purposes, MC should exercise its power to monitor and audit the clearing and settlement system on an on-going basis and ensure the system's accountability. A set of rules and procedures need to be developed by MC to be able to detect and deter possible problems. Relevant operating procedures also need to be made available to the public. In addition, risk management would also require that the system developed by KCC should aim at ultimate dematerialization of outstanding securities and become fully automated on the basis of book entry. This requires an amendment to the current law; otherwise investors cannot be compelled to allow total immobilization and dematerialization. The new rules should arrange for cross-border transactions.

Table 2. Kuwait: Summary Observance of the IOSCO Objectives and Principles of Securities Regulation

Assessment Grade	Principles Grouped by Assessment Grade	
	Count	List
Fully implemented		
Broadly implemented		
Partly implemented	25	P 6,7,8,9,10,11,12,13,14,15,16,17,18,19,20,21,22,23,24,25,26, 27,28,29,30
Not implemented	5	P 1,2,3,4,5
Not applicable		

Recommended Actions and Authorities' Response to the Assessment

Table 3. Kuwait: Recommended Plan of Actions to Improve Observance of the IOSCO Objectives and Principles of Securities Regulation

Reference Principle	Recommended Action
Principles Relating to the Regulator (CP 1–5)	
CP 1	• The objectives, responsibilities, functions and authorities of the securities market regulator (MC) should be clearly defined by and stated in one comprehensive law unifying present laws; to be formulated in line with relevant technical and prudential principles and requirements of securities markets. • The law should set the basic principles regarding the objectives that the regulator should meet: (1) protection of investors, (2) ensuring that markets are fair, efficient and transparent, and (3) the reduction of systemic risk. • The law should give the MC a full, comprehensive, and overall power to develop, organize, and regulate the securities market and to license, regulate, and sanction all types of market intermediaries and participants. • The MC should have the necessary power to enforce the law, executive regulations, and decisions setting the basic principles regarding the objectives that the regulator should meet. • The MC should be empowered to set the rules and regulations that would continuously meet the market's changing requirements, keep pace with development needs, and keep the market in order and maintain its integrity.

Reference Principle	Recommended Action
CP 2	• The law should create an "independent and an accountable authority" with a clear organizational structure. Independence, in terms of resources and ability to take enforceable decisions, needs to be clearly established by law. • For improved transparency, the audited financial statements of the MC should be published in its annual report and on its web site. • There should be a judicial mechanism in place to allow the contestation/appeal of MC decisions.
CP 3	• The MC should develop a wide spectrum of sanctions including cash fines. It should be empowered to impose these sanctions, preferably by law.
CP 4	• The law should set a rule for rulemaking requiring the development of a process and mechanism for consultation with the public and market participants before a law or a rule is adopted. • The MC should regularly report on the outcome of investigations or inquiries. The report should be published to provide guidance to market participants on problems that should be avoided. The report should include guidelines on how intermediaries and market participants can best comply with legal requirements.
CP 5	• Rules and instructions regarding observance of confidentiality need to be established. It should be supplemented with an explicit code of ethics applied to the MC's personnel.
Principles of Self-Regulation (CP 6–7)	
CP 7	• The law should clearly state that the MC has the right and power to license, oversee and inspect the activities of the KSE. On-site, routine inspections should be performed on a regular basis to ensure that the KSE abide by the rules. Moreover, the MC should have the power to authorize self-regulation, and should have more deterrent sanction powers including pecuniary sanctions over SROs.
Principles for the Enforcement of Securities Regulation (CP 8–10)	
CP 8	• The MC should be empowered by law to develop and enforce comprehensive inspection, investigation, and surveillance. • Pending the amendment of the current legal framework, regulating agencies, namely the MC, the CBK, and the CD should formalize a procedure for consultation and the exchange of information, and for combining inspection and

Reference Principle	Recommended Action
	investigation efforts. • Regular and routine on-site inspection should be implemented by supervising agencies. Inspection reports by the CBK and other agencies should be sent to the MC for information and perusal. • The abuse of insider information needs to be prohibited by law. A set of rules and regulations together with comprehensive guidelines and procedures should be adopted and put in place to deter and detect insider trading.
CP 9	• A wide spectrum of sanctions needs to be authorized and should include cash fines. The MC should have the power to sanction all types of market intermediaries.
CP 10	• The MC should be empowered to develop and implement an effective law compliance program, which should be followed by all intermediaries.
Principles for Cooperation in Regulation (CP 11–13)	
CP 11	• Although the law authorizes the MC to cooperate with other agencies and counterpart authorities, a procedure needs to be in place to formalize this process and allow the sharing of public and nonpublic information with domestic agencies and foreign counterparts. The law should explicitly state that the MC could share nonpublic information.
CP 12	• It is suggested that a MOU similar to the one with foreign authorities or any other formal tool be put in place and signed with domestic authorities.
CP 13	• The MC should consider becoming a member of IOSCO with a view to improving means of cooperation with other regulators. Meanwhile, the MC should consider the development and signature of the international collective MOU, which is prepared by IOSCO.
Principles for Issuers (CP 14–16)	
CP 14	• The MC should be empowered to issue a set of rules and regulations as well as procedures, including the right to adopt specific accounting requirements for disclosure, regarding the organization of the public offering of securities. • The MC should be empowered to regulate and oversee the IPO and PO processes. • The MC should also be empowered to regulate tender offers, mergers and acquisitions.

Reference Principle	Recommended Action
CP 15	• MC needs to put in place a clear system to be followed by shareholders who want to increase their ownership above the current threshold of 5 percent. • The MC should set the rules for the protection of minority shareholders. • The MC and the KSE should compel listed companies to implement principles of corporate governance to ensure a fair and equal treatment of shareholders. This should be a condition for initial and continuing listing on the KSE.
CP 16	• The MC should build capacity to examine the compliance of auditors and audited companies with accounting and auditing standards, as well as other disclosure requirements. The MC should arrange for a program of ongoing training for its staff. • It is suggested that auditors of listed companies and licensed intermediaries be approved by the MC.
Principles for Collective Investment Schemes (CP 17–20)	
CP 17	• The CBK, the CD, and the MC should establish a formal consultation mechanism for the establishment, licensing, inspection, and investigation of CISs. • Auditors of CISs should be approved by the MC. • It is suggested that a plan be considered for the promulgation of one comprehensive securities market law requiring the full supervision and regulation of CISs (as well as all intermediaries) by the MC as the sole regulating agency.
CP 19	• The classification of mutual funds by categories, reflecting different investment strategies (equity, fixed income, money market, mixed, etc.). should be clearly defined. • It is suggested that the prospectus of an investment fund be published, once approved by the CBK. The MC should also approve it.
CP 20	• The parameters and system of calculating the NAV of CISs need to be established and published following approval by the MC and the CBK. • It is suggested that the NAV of the fund be published on daily basis. All CISs should implement a unified practice with respect to asset valuation, pricing of units, and redemption procedures.
Principles for Market Intermediaries	

Reference Principle	Recommended Action
(CP 21–24)	
PC 21 and 22	• The law should clearly define entry standards for all types of market intermediaries and provide for prudential regulations governing their licensing, supervision, and sanctioning. Owners and officers of licensed intermediaries should be subject to fit and proper tests to be developed by the MC. • The CD, the CBK, and the MC should, in the interim, formalize a mechanism and procedure for consultation, cooperation, and combining efforts for the licensing, regulation, and supervision of present market intermediaries.
PC 23 and 24	• The MC should be empowered to set prudential rules and regulations to govern all types of intermediaries and approve their code of ethics. Intermediaries should be required to establish clear internal procedures in full compliance with rules and regulations. • A compliance officer should be appointed for each intermediary. • The MC should be empowered to inspect the books, records, and business operations of presently licensed intermediaries and all intermediaries to be established in the future based on regular inspection. • The MC should be empowered to impose necessary and relevant sanctions that would provide full protection to clients. • The MC should implement the current plan for the establishment of an IPF to protect clients against the financial insolvency of financial intermediaries or their bankruptcy.
Principles for the Secondary Market (CP 25–30)	
CP 25	• The MC and the KSE should have separate organizations, structures, and management. • Clear rules need to be adopted to avoid conflict of interest between concerned parties and within the management of the KSE and the MC. • The MC should be empowered to license the KSE and future KSEs if any.
CP 26	• The MC should perform regular on-site inspections of the KSE to be better able to continuously assess the reliability of the arrangements made by the KSE for monitoring and supervising the trading system.

Reference Principle	Recommended Action
CP 27 and 28	• Insider trading should be immediately prohibited by law • The KSE, under the supervision of the MC, should develop a system to deter and detect unlawful and fraudulent practices.
CP 29 and 30	• The law should allow for the dematerialization of securities. The KCC should develop the capacity for depository purposes. • The KCC should be able to become a central corporate registry of securities ownership in order to facilitate observance of corporate governance principles.

Authorities' response

45. The authorities in Kuwait are in broad agreement with the assessment and recommendations. In recognition of the recommended reforms to the securities market and the need for immediate initiation of the reform actions, the KSE has prepared a four-year development plan to be implemented as soon as possible. The plan is based on the detailed assessment and aims, inter alia, at improving the regulation and the regulatory framework, strengthen the enforcement and the supervisory role of the market regulator and improve the current stock exchange mechanism and systems. It is expected that the implementation of the four-year plan will institutionalize a dynamic process for the reform and development of the securities market in conformity with the international standards and best market practices.