Securities markets and protection of small investors in public shareholding companies of United Arab Emirates

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Abstract

Purpose – The purpose of this paper is to review the laws in relation to the role of the securities markets in protecting small investors and examine legal cases that have recently been observed in this area.

Design/methodology/approach – A research-based qualitative analysis was undertaken to determine the governing authorities on the subject of international trade contracts globally. Various internet searches were conducted and information was collected to represent the subject at large and to the best and most current understanding. The information was assessed in its joined context to prepare recommendations for best practice.

Findings – In the United Arab Emirates (UAE), the rights of small investors in public shareholding companies are protected through many different legal stipulations that all must adhere to in order to offer stock. Through an examination of the laws of the UAE in relation to securities markets' roles and responsibilities, a clear picture of protection is created that ensures small investors' risks are minimized. In this regard, the UAE has implemented additional regulations in comparison to any other country as evident through the Doing Business Report (2014).

Research limitations/implications – The review of available documents is limited to UAE and hence cannot be generalized into a broader context.

Originality/value – This paper work contributes the research about the existing conditions of securities markets of protected small investor in UAE stock exchange market as serious as that of protecting the national economy.

Keywords Market, Company, Shareholder, Investor, Protect

Paper type Research paper

1. Introduction

Protecting investors in any market is important, as it determines the ongoing nature of business – where there are no safeguards in place, investors are not as ready to take a risk as they would otherwise. Small investors in particular have more to lose in any investment, be it within a public shareholding company or within another realm of business.

This paper focuses on the role of the financial market (stock market) in safeguarding small investors in UAE public shareholding companies. Within the UAE, legislation favors national investors over foreign investors, but both categories can be seen to have certain safeguards and restrictions in place when it comes to investing in public shareholding companies (Ola Salem, 2013). In the UAE, the two stock exchanges are the Abu Dhabi Securities Market and Dubai Financial Market as well as the Dubai Gold and Commodities Exchange (IIF Equity Advisory, 2007).

Companies issuing stock in the UAE are held to a stringent set of generally accepted international accounting principles, which help to bring transparency to stock purchases

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and to company activities so that investors can feel safe in the knowledge that they understand and have a full awareness of the company activities they invest in. The UAE considers the task of protecting investors as serious as that of protecting the economy and understands that the two are interlinked. Ensuring that there are clear rules that both companies and investors need to follow creates stability and attracts foreign investors (Ola Salem, 2013).

Comparatively speaking, Arab securities markets are newer than most. This has been a benefit, in that the financial market in UAE among other Arab nations was able to use the lessons that could be seen from foreign markets and integrate a truly comprehensive set of legislation to ensure that the problems that have arisen in foreign markets will not do so within the UAE markets (Lees, 2012). Additional steps are being reviewed to add to an already strong set of legislation that will allow the UAE market and businesses within it become more attractive to small foreign investors.

Among these updates are the areas of Insolvency, Company law and Arbitration law as well as Foreign Investment Laws (OECD, 2019). One goal is to reduce the steps that need to be undertaken to invest as a foreigner or a small investor, while another goal is to strengthen and clarify existing rules in relation to the same. It is worthwhile to review the stance of a small investor without reviewing the restrictions placed on foreign investors.

The following main question needs to be researched in this report: What role the financial market plays in the protection of small investors in UAE public shareholding companies?

In particular we address the following three questions:

(1) Are small investors in UAE public shareholding companies protected?

(2) If so, how are they protected (and through what mechanisms)?

(3) Who holds responsibility for ensuring that small investors are protected?

2. Institutional and legal environment

There are 135 issues on the UAE Stock Exchange; of these, foreign investors are allowed to invest in 108 (Abu Dhabi Securities Exchange, 2019). The remaining issues are government entities such as oil companies and telecommunications. Foreign investors are limited by per cent to only being able to invest in and own up to 49 per cent of any one company. This is, however, a matter for each company to determine in relation to whether they will allow a full 49 per cent to be a foreign investment; up until 2013, there were many companies in the UAE whose by-laws prohibited foreign investment. It was only in relation to the upgrading of the UAE economy, according to “Standard & Poor’s”, from a “frontier” economy to an “emerging” one, which caused a large number of UAE companies to change their by-laws and allow a full level of foreign investment. With regard to foreign investment, there are four main laws that are always for consideration:

(1) The Companies Law;

(2) The Commercial Agencies Law;

(3) The Industry Law; and

(4) The Government Tenders Law (Allen and Overy, 2015)

Out of the four, Companies Law has the highest impact on a foreign investor. Revision to the Commercial Companies Law came into effect in July 2015 (Gulfbase, 2015). Of particular interest to small investors, the financial assistance aspect of the revised law now prohibits any bank or financial institution that issues bonds from providing any financial help to an investor in order to facilitate the investment. There is a provision within the revised law which will allow the Cabinet of Minsters the ability to limit sectors of the market to national investors only, meaning that a new area other than oil or telecommunication (or other government-defined sectors) could potentially see a restriction on foreign investment in the future (Table I).

In a report released by the UAE Ministry of Economy in January 2015, the number of private companies issuing stocks across all emirates totaling 145, represented a capital income of AED 131.3bn. This can be taken as an indicator that there is a high potential of successful investments. The report noted that Dubai in itself represented 71.9 per cent of the total capital registered accounts in the country. The report also noted that 45 of the 145 companies listed were in Dubai.

2.1 Public shareholding companies

For the small investor in UAE public shareholding companies, an understanding of the requirements of this business entity is highly recommended, as it will greatly increase peace of mind and simply because of the fact that the rules are clear and concise.

Within a public shareholding company, a minimum of 55 per cent of shares have to be on offer to the general public. There is a DH 10mn capital requirement, with one-fourth of that settled on subscription. Shareholders are never liable for more than their investment. There is a minimum requirement for ten founders to be in any public shareholding company unless there is involvement on a governmental level and then the number may be relaxed. All stock shares are required to be logged into a share register, and it is illegal to offer any stock below the set nominal price. Each share has an equal voting right as any other share so there is no priority given to any certain investor (Santander Trade Site, 2016).

Money laundering is strictly forbidden in the UAE in line with the global standard. To ensure that shareholders are not attempting or facilitating money laundering through buying or selling shares, the central bank is required to hold the names of any shareholder that holds more than 5 per cent in shares relating to any one public shareholding company.

There is a minimum of 3 and a maximum of 12 board members required on any board of directors, a majority of whom, including the chairman, must be a UAE national. If a public shareholding company loses half its value at any one time, there is onus on the board of directors to vote on dissolution. If no meeting is called in this regard, it opens a legal path for an interested party to initiate court action to force dissolution.

In line with internationally accepted principles, the UAE suggests that investors take the task seriously by researching the company before investing, reading through the accounts, which are provided at a uniform standard for any foreign or national investor to understand,

	United arab emirates	Middle east and north africa	USA	Germany
Index of Transaction Transparency[a]	4.0	6.0	7.0	5.0
Index of Manager's Responsibility[b]	7.0	5.0	9.0	5.0
Index of Shareholders' Power[c]	2.0	4.0	9.0	5.0
Index of Investor Protection[d]	4.3	5.0	8.3	5.0

Notes: [a]The greater the index, the more transparent the conditions of transactions; [b]The greater the index, the more the manager is personally responsible; [c]The greater the index, the easier it will be for shareholders to take legal action; and [d]The greater the index, the higher the level of investor protection
Source: Doing Business (2014)

Table I. Country comparison for the protection of investors and by understanding the strength and position of the company in relation to the market (PWC Middle East, 2015).

3. Methodology and findings

A research-based qualitative analysis was undertaken to determine the governing authorities on the subject of international trade contracts globally. A questionnaire was also put together and disbursed in relation to seeking direct evidence from investors. An analysis of the responses was made.

Various internet searches were conducted and information was collected to represent the subject at large and to the best and most current understanding. The information that was assessed in its joined context to prepare recommendations for best practice in the UAE Securities Markets includes:

- Preference for liquidation, which allows the shareholder (investor) to earn a fixed amount of actual income equal to the initial purchase price multiplier of the investor and any dividends still unpaid and declared before any asset being distributed to common shareholders when a liquidation occurs.
- Redemption rights mean that the investor has the ability to sell his shares back to the company based on a minimum price and on a certain date.
- Voting rights include investors being allowed to have a vote in electing at least one, if not more, board member to any public shareholding company that issues stocks. There would also be a right to vote on certain actions that the corporation might undertake such as issuing new shares, mergers or acquisitions.
- Right to pre-emption means that the investor may have a claim on any future stock issuance by way of a first right of refusal that is in relation to the per cent of shares the investor owns at the date of new stock issue.
- Right of first refusal requires companies to ensure and facilitate the ability for other stock owners to buy any shares that another shareholder wants to transfer.
- For "Tag-along rights", public shareholding companies in the UAE are required to allow shareholders to participate in any sale; effectively; this acts to limit the company owner to sell their interest unilaterally. Stockholders are allowed a vote and the majority would win; this would also act to introduce "drag-along rights", which prevent other investors from objecting to a sale once it has been approved by the majority.
- Founder's shares are vested to allow the company the ability to buy back any or all of a founder's unvested shares, if the founder wishes to end their employment with the company (Hamdan, 2011).
- There is a requirement placed on all investors that the capital should be paid in full.
- Audited budgets which are issued for the previous two fiscal years
- Shares must be traded through a brokerage company that is licensed by the securities and commodities authority.
- It is the market that is responsible for determining the share pricing mechanism after the shares are listed as well as the amount of share price movements and hours of trade.
- If any shareholder believes that the company is operating outside of the law within any particular transaction, they may file a court petition requesting that the transaction be suspended.

- Annual financial statements must disclose any dealings over the past year of the company that had any involvement with either family or business ties of anyone in the company or on the board of directors.
- Approval must be granted by the Central Bank UAE before any public shareholding company is allowed to offer stock for sale (US Department of State, 2013).
- The Commercial Companies Law No. 8 (1994) provides within Article 166 that company assets cannot be attached to any debt that is incurred by any shareholder, although the shareholder's creditors are allowed to attach the shares and dividends accrued from those shares.

There is a requirement before the board of directors of any public shareholding company issues stock that they must provide an accurate financial prospectus, which represents the company's position and includes any pertinent facts to the public. Such prospectuses are required to be published in two separate newspapers that have daily edition printing. All information must be accurate and the founding members are held responsible for any misinformation that is produced.

If founders determine that they are going to rescind the incorporation of the company, they are required to refund the investments made by shareholders prior to doing so.

In the "Doing Business Report" of 2014, the UAE was heralded as doing more to protect minority stakeholders than any other nation in the world (Jacobsen, 2015). Considering the overall level of safeguards in place, investors in UAE public shareholding companies are as protected as any investor internationally; arguably, it could be said that the stringent rules held for companies issuing shares in the UAE create a higher level of stability and clarity for any small investment. Companies are all vetted on a national level before being allowed to issue shares in the UAE, which is something that other countries do not have, so there is knowledge that the choices of stock on offer are consistent in their stability.

4. Risks

For all of the safeguarding that has been put in place to ensure that small investors in public shareholding companies are safe in their investment through a highly regulated system, investing in a UAE market as a small investor does not come without risks. For example, if a public company sells stock to small investors and then in time decides to become a private company, the small investors only have a small window of opportunity (two days is the normal time frame), in which they can sell their stocks in the company, as by being delisted as public the investor would be unable to keep the shares. This has caused certain small investors to lose their investment entirely through not being able to find a buyer in the short time frame available or being forced to accept a great loss when a buyer is found.

5. Legal redress for small investors

Even with the clarity of company–law requirements in the area of public shareholding company responsibilities and investor rights, there are times where legal redress has been instituted. In December 2014, a lawsuit was initiated in Dubai against Dubai Citibank (Augustine, 2014) for loss suffered by investors in their company. The lawsuit (No. 2901/2014) alleged that Citibank subsidiaries in Abu Dhabi (Citi Private Bank, Citibank International Plc and Citi Private Bank-Abu Dhabi) their losses that accrued in their real estate asset management fund from investors even when there were instances among the investors where total loss of investment was realized.

At the heart of the case was a question over whether a deal in relation to UK property was for the purchase of real estate that was effectively owned by the fund's manager without disclosing the inside nature of the relationship that facilitated the deal to the investors. A recent lawsuit relating to UAE investors is that of a Dubai-based company Gold AE, a website service that offers gold and silver for sale, whose current management has just filed criminal charges on the previous management that was replaced in early 2015 (March), citing fund mismanagement and fraud. The current management states that investors were defrauded and that they were not in a position to reimburse anyone, as the current management did not have official access to any commodities, funds or assets owned by the company (Al Sayegh, 2016).

The company was registered in the Dubai Multi Commodities Center (DMCC), and reports from investors stated that the company stopped site access in October, while in November, their trading license was revoked for reportedly being in breach of its terms of its license or of the DMCC. On 16 December, Gold AE sent an email to its investors stating that during company audits, the new management found that the old management had misappropriated a significant amount of its client's assets and transferred the cash to different countries including Turkey, Switzerland, Saudi Arabia and Jordan (Basaiah, 2012). The new management suggested that investors also take up individual arbitration cases against the old management to settle the matter.

6. Direct evidence questionnaire

To measure the level of understanding Among the regulations and investments of UAE investors, a questionnaire was developed Which contained six specific questions relating to the above context. Ten respondents were chosen after a request for willing respondents to participate in the study was put out. The following six questions were explicitly requested; names were not asked and the responses were anonymized to consider the proportionality of their answers.

(1) Have you invested in a UAE public shareholding company?

(2) Do you know what investment protection you have in the UAE?

(3) Do you know who is responsible for protecting investments in the UAE?

(4) Do you have investments with any oil company?

(5) Do you have investments with any telecommunications company?

(6) Do you have investments outside of the UAE?

7. Response summary

All respondents confirmed that they have or held investment in securities in the UAE. Of the total respondents, 80 per cent had invested in real estate in the form of a public shareholding company. Of the total respondents, only 50 per cent knew who was responsible for protecting their investments in the UAE. Additionally, all respondents had investments outside of the UAE as well, although the questionnaire did not ask for any further breakdown in that regard. Of the total ten respondents, four reported having an investment in an oil company of some nature and three of ten respondents noted that they had investments within the telecommunications industry. Industries were not further broken down within this questionnaire to keep the answers relevant at a large scale.

None of the respondents were able to say that they definitively knew what specific protections were in place to safeguard their UAE investment, though 50 per cent were able to name the office responsible for oversight in protecting investments in the UAE. This shows that it is likely that the only way in which an investor would know if their investment were not in line with trading standards would be through the notification of such by the proper authorities. It notes an overall reliance on investors to trust in the system that they invest under so that they are not expected to maintain the responsibility of determining if the investments they make are with companies that are in full legal compliance. Alternatively, it denotes a system wherein the investors rely on the authorities to stay abreast of such matters and investors believe that their investments are generally safe in the UAE.

Overall this would imply that the structure by which regulations are made and overseen relating to investments in the UAE, is seen to be stringent and trustworthy.

8. Conclusion and recommendations

Through multi-layered accounting that is required for all public shareholding companies in the UAE, the role of financial market in protecting the small investor is clearly defined. This allows investors peace of mind and attracts attention from global investors who all see the benefits that a highly regulated financial market provides. Through implementation and stringent application of the most comprehensive set of regulations as compared globally to other Commercial Law areas, an attractive investing option for UAE public shareholding companies is created. Small investors in the UAE public shareholding companies are advised to use due diligence when choosing a company to invest in. The following recommendations can be made.

Small investors should review the prospectus of any public shareholding company they wish to invest in so that they gain a full understanding of the position of the company and the future direction. Investors are advised to ensure that they are buying shares from a certified broker. Ongoing business of the company should be followed to ascertain whether the investment is proceeding as planned. Voting rights and other shareholder rights should be used to give the highest level of control to small investors. Investors should make sure that the company they are considering to invest in is reputable and that the shares have not been diluted.

From the responses of the questionnaires, it can be seen that the regulations which override investments in the UAE are relied upon by investors and that they often do not even know what makes an investment safe or what particular regulations exist for the industry or the investment they hold. This shows the importance of having a stringent and comprehensively regulated and defined set of laws relating to the securities market and protection of small investors in public shareholding companies of the UAE.

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