INTERNATIONAL CAPITAL MARKETS

Law and Institutions

CALLY JORDAN

Consultant Editor
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PREFACE

This book has had a long gestation. I have followed the development of international capital markets over the last 30 years, from a number of different perspectives: Wall Street practitioner, law professor, international bureaucrat. Each viewpoint has brought its own insights and raised its own questions.

An important caveat though. The book is not a treatise, and is certainly not exhaustive. The aim is more modest, to provide a context in which to better understand the international dynamics of capital markets, their institutions and regulation.

Inevitably, the United States, the United Kingdom, and Europe, together with that venerable market institution, the exchange, absorb the lion's share of attention. The new roles of international financial institutions and organizations, such as the Financial Stability Board, The World Bank, and the International Organization of Securities Commissions, are examined. I have included a chapter on Hong Kong and China and another on niche markets, but a consideration of the fascinating 'rise of the rest', emerging and transition markets more generally, must await another day, and another book. There was neither time nor space to do them justice. A further caveat, as obvious as it may be, bears mentioning. Capital markets, their regulation, and their institutions are changing, fast.

The London School of Economics, the British Institute for International and Comparative Law, and the Netherlands Institute for Advanced Study in the Humanities and Social Sciences, all provided me with visitorships and an intellectual home during the writing of this book. In particular, my thanks to the PRIME Finance Foundation (The Hague) for the inaugural Lord Woolf Fellowship and the Centre for International Finance and Regulation (Sydney, Australia) for its financial support.

Robin Gardner and her team, in particular Cate Read, at the Law Library Research Service, University of Melbourne, were terrific. A book needs time, and Andrew Kenyon, my Deputy Dean at Melbourne Law School, devised a 'write now; pay later' plan. Fittingly enough, the book also benefited from the enthusiasm and unstinting diligence of a very international cohort of research assistants, working from Melbourne, Singapore, Montreal, and parts in between. So my special thanks to Brendan Donohue, Sahil Sondhi, Elizabeth Goodman, and Michael Zhengpeng Chen (Melbourne Law School). At the Faculty of Law at McGill University, John Zelenbaba and his colleagues, Marco Garofalo and Hugo Margoc, provided invaluable support and assistance over the long haul. My thanks also to other McGill law students, Inhong Kim, Nancy Zagbayou, and Katherine Kalinin for their research during the initial phases of the book, and to their Dean, Daniel Jutras, for helping me recruit them. My great thanks to them all.

Thanks too must go to those legions of students over the years who have participated in my courses on international capital markets, at McGill, Osgoode Hall, Georgetown, Duke, Florida, IUC Torino, Melbourne, and the Center for Transnational Legal Studies (London). They brought to the classroom their enthusiasm, ideas, and sharp minds.

A great many people took the time to talk to me, set me straight, and point me in interesting directions: Paul Dudek, Don Langevoort, Eric Pan, and my former colleagues at The World Bank and the IFC (in particular, John Hegarty) in Washington, DC; Jim Cox and Lawrence Baxter in Durham, NC; Pam Hughes in Toronto; Les Silverman in New York City; Brian Cheffins, Len Sealy, Jane Welch, Ruben Lee, Richard Britton, David Kershaw, Stefano Pagliari, Jo Braithwaite, Dan Awrey, Jacek Kubas, David Lawton, and Frédéric Gielen in the United Kingdom; Harold Baum, Walter Doralt and Rüdiger Veil in Hamburg; Doug Arner in Hong Kong; and Greg Tanzer in Madrid and Sydney. My thanks also to Roberto Caranta (University of Torino) and David Luban (Georgetown Law Center) for offering me the opportunity to participate in hosting a workshop, *The Aftermath: Crisis and Legal Change—Future Prospects for Capital Markets, their Regulation and Institutions*, at the Center for Transnational Legal Studies, London, in April 2013. The book gained much from the discussions and all the participants.

My great thanks also to Jeff Golden, my consultant editor, for generously undertaking the task of reading the manuscript, despite heavy prior commitments (and likely against his better judgment). For his efforts, Jeff gets the last word.

The usual disclaimers apply.

Lastly, of course, my gratitude to John and Stephanie, for their patience, understanding, and unwavering support throughout the writing of this book. You are the best.

Cally Jordan
May 2014
Melbourne

CONSULTANT EDITOR'S NOTE

We are very fortunate to have this new work by Professor Cally Jordan and the critical and comprehensive analysis that it contains of the international capital markets, their regulation and their institutions. If the financial turmoil of the past half-dozen years has taught us nothing else, it has been that our prior understanding of all this was woefully inadequate for the challenge when things did not go according to plan. What we have learned the hard way is the lesson of the danger of complacency when contemplating global finance—taking too much for granted or, worse yet, putting our heads in the sand and too much trust in conventional wisdom.

We all know Hans Christian Andersen's tale of *The Emperor's New Clothes*: the vain sovereign who wants desperately to be 'well-covered' and is constantly changing clothes but who gets his real comeuppance when his weavers send him out naked with the false assurance that the Emperor is indeed suited in the height of fashion. The garb that protects him, it is alleged, is in fact beautifully complex and designed for sophisticated needs and tastes. 'Only those unfit for their position, stupid or incompetent would fail to appreciate that.' In the end, sanity is restored only when a young lad looks at the parading sovereign in an unblinkered way and asks, 'Where are your clothes?'.

The story is well known and the message is clear: the facts are important, and even more importantly, don't ignore or turn a blind eye to them when you present yourself as suitably dressed and fit for purpose – or you may do so at your peril! Why should it be any different in the case of today's international capital markets and attempts to regulate or 'dress' them in order to provide protection against the elements?

The moral of *The Emperor's New Clothes* is universally appreciated. However, possibly less well-appreciated or even known is a more modern, arguably ironic, twist in the tale. When Queen Elizabeth II opened a new building at the London School of Economics in 2008, and after having been briefed by academics around her about the origins and effects of the financial crisis, she simply asked that, if all that was so obvious, how come everyone missed it? On this occasion the recent institutional failings and ensuing market turmoil and exposure were very much on everyone's mind. But this time it was the sovereign who knowingly pointed the critical finger.

Well, the fact is not everyone who should have, did 'know all that', and, indeed like the Emperor in the fairy tale, few were prepared to admit their ignorance and preferred to believe that the markets themselves had found new and clever ways of managing risk.

In this book, Professor Jordan gives us an opportunity to study the history, sociology, and policies that shape global finance as well as a chance to learn from the mistakes of the past. That is the first reason why *International Capital Markets: Law and Institutions* is so timely: it tells us more about what we should have known about the international capital markets, key institutional players and how the scheme of things came to be the way it is. All of that is important if we now are to think carefully about where we go from here. And that story is told in an engaging way; those of us who know Professor Jordan and have had the benefit of her lectures and counsel will hear Cally's voice, and delight in her inimitable style, as we read the pages that follow.

The second reason why the book makes a timely entrance is that it arrives at a moment when practitioners in the field, and students trying to come to grips with it, are being overwhelmed by major capital market institutional reform and inundated with relevant new rules and regulations. When the second anniversary of the passage of the Dodd-Frank Act, a key piece of US legislation discussed in the pages that follow, was celebrated this past summer, it was also reported to have generated more than 14,000 pages by then and yet the job of its rule-making was said to be less than 40% complete. With legacy and new legislation and rule-making spread around the world and often in different languages, synthesizing all the relevant text is a challenge. Helpfully, Professor Jordan gives *con*text to text, which makes the challenge more manageable. The author says that providing context is a modest ambition. I say that it is both a relevant and particularly important one at this juncture in time.

I hope that other readers of *International Capital Markets: Law and Institutions* will benefit from Professor Jordan's book as much as I feel that I have. In fact, I am certain that they will!

Jeffrey Golden
London
May 2014

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FPI	foreign private issuer
FSA	Financial Services Authority
FSA 1986	Financial Services Act 1986
FSB	Financial Stability Board
FSAP	Financial Sector Assessment Program
FSMA 2000	Financial Services and Markets Act 2000
FSF	Financial Stability Forum
FSOC	Financial Stability Oversight Council
GAVI	Global Alliance for Vaccines and Immunization
GDRs	Global Depositary Receipts
HFT	high frequency trading
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IBFIM	Islamic Banking and Finance Institute of Malaysia
ICIFB	Institutions Conducting Islamic Financial Business
ICMA	International Capital Markets Association
ICSD	Investor Compensation Schemes Directive
IFI	Islamic Financial Institutions
IFFIm	International Finance Facility for Immunization
IFR	Islamic Finance Rules
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IIRA	Islamic International Rating Agency
IIROC	Investment Industry Regulatory Organization of Canada
IMF	International Monetary Fund
INCEIF	International Centre for Education in Islamic Finance
IOSCO	International Organization of Securities Commissions
IPMA	International Primary Markets Association
IPOs	initial public offerings
ISD	Investment Services Directive
ISDA	International Swaps and Derivatives Association
ISE	Irish Stock Exchange
ISMA	International Securities Markets Association
JAB	Joint Arab Bourse
JOBS Act	Jumpstart Our Business Startups Act 2012
LCFI	large complex financial institution
LIFFE	London International Financial Futures and Options Exchange
LMC	Liquidity Management Centre
LSE	London Stock Exchange
MAS	Monetary Authority of Singapore
MBS	mortgage backed securities
MiFID	Markets in Financial Instruments Directive
MJDS	Multijurisdictional Disclosure System
MOU	Memorandum of Understanding
MTF	Mutual Trading Facility
NASAA	North American Securities Administrators Association

NASD	National Association of Securities Dealers
ODO	overseas directed offering
OTC	over-the-counter
PF(I)A	Prevention of Fraud (Investments) Acts 1939 and 1958
PRA	Prudential Regulation Authority
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
QIB	Qualified Institutional Buyer
REITs	real estate investment trusts
SCNPC	Standing Committee of the National People's Congress
SE	Societas Europaea
SEAQ	Stock Exchange Automated Quotation
SEC	Securities and Exchange Commission
SEFs	Swap Execution Facilities
SEZ	special economic zone
SFC	Securities and Futures Commission
SIB	Securities and Investment Board
SIFIs	Systemically Important Financial Institutions
SFC	Securities and Futures Commission
SNB	Swiss National Bank
SROs	self regulatory organizations
STI	Straits Times Index
SUSMI	substantial US market interest
TIA	Trust Indenture Act 1939
UCIs	Undertakings for Collective Investments
UCITS	Undertakings for Collective Investments in Transferable Securities
US 1933 Act	Securities Act of 1933
US 1934 Act	Securities Exchange Act of 1934
USM	Unlisted Securities Market

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NICHE MARKETS AND THEIR LESSONS*

1. Introduction

Markets are full of nooks and crannies. Out of the glare of the big economies and their public exchanges, markets specializing by financial product, activity, or industry thrive, often attracting little by way of formal regulatory oversight.[1] Industry associations, such as ISDA,[2] or even membership in a particular social group,[3] have provided the rules of engagement. 9.01

These markets may be primarily domestic, centred in the big economies, but are often inherently international, operating in blissful (or wilful) oblivion to national regulatory strictures. These specialized markets are quite resistant to formal regulatory oversight.[4] As interdependence of financial markets, products, and participants grows, though, the operation of these specialized markets becomes increasingly significant. Until the global financial crisis, for example, credit default swaps attracted little attention among the general public and 9.02

* The author would like to thank Sahil Sondhi (Melbourne Law School), in particular, for his assistance with this chapter.

[1] The specialized weather derivatives market, which allows firms to hedge against variable weather conditions, is one prominent example. Enron was a party to the first weather derivative trade in 1997, and energy companies continue to be the biggest users of these instruments. Unmindful of the post-financial crisis regulatory imperatives of standardization and exchange-trading, demand for sophisticated, bespoke over-the-counter weather derivatives is growing 'far more quickly' than in the standardized contract market: 'Weather derivatives: Come rain or shine', *The Economist* (4 February 2012) <http://www.economist.com/node/21546019>. A specialized 'niche' market is not one that is necessarily systemically trivial: the notional value of the now infamously-underregulated global credit default swaps (CDS) market reached US$67 trillion in 2008—more than four times the value of its underlying assets: Lynn A Stout, Jean Helwege, Peter J Wallison and Craig Pirrong 'Regulate OTC Derivatives by Deregulating Them' (2009) 32(3) *Regulation* 30, 33.

[2] ISDA began as the International Swap Dealers Association in 1985 at the time of development of interest rate and currency swaps, quite revolutionary financial products at the time but which now appear very simple instruments in hindsight. With the burgeoning markets in derivative products of increasing complexity, ISDA kept its acronym but changed its name to the International Swaps and Derivatives Association.

[3] For example, the Hassidic Jewish community and the diamond merchant trade in New York City, with its close ties to diamond markets and merchants in Antwerp.

[4] For example, the industry associations for participants in the Euromarket successfully evaded the regulatory net of the Investment Services Directive in 1992 by beefing up the industry association rulebooks and arguing persuasively for the 'eurosecurities' exemption tailored to their particular market. They were not so successful the second time around with the Prospectus Directive in 2003. Equally, the swaps markets in the United States escaped regulation in the Commodity Futures Modernization Act of 2000. Similarly, a 2008 report by the English and Scottish Law Commissions determined that the centuries-old concept of 'insurable interest' was inapplicable to CDS. Instead, the regulation of CDS—which in substance essentially resemble insurance contracts—was deemed better left to the marketplace. See English and Scottish Law Commission, *Insurable Interest*, Insurance Contract Law Issues Paper 4, 2008. See also Cally Jordan, 'The Dangerous Illusion of International Financial Standards and the Legacy of the Financial Stability Forum' (2011) 12 *San Diego International Law Journal* 333, 337–40.

few people had heard of, much less were concerned with, the way in which LIBOR[5] was calculated.

9.03 But there is another kind of specialized market, one which is geographically and politically determined albeit internationally focused. The jurisdictions in which these markets are situated become known as international financial marketplaces in their own right: Luxembourg, Ireland, Dubai, Bahrain, Malaysia, Singapore, Switzerland, among others. These are some of the world's niche markets.

2. Characteristics of Niche Markets

9.04 With the exception of Malaysia, which may be the outlier in this group, these niche markets are all small,[6] geographically challenged and independently minded countries which, for various geopolitical reasons, have never reaped the economic benefits of expansion and empire.[7] They have had to be resourceful and self-sufficient, and yet at the same time make the most of relationships with a larger hinterland or a former colonial power.

2.1 Advantages in diversity

9.05 Niche markets demonstrate linguistic advantages in their diversity, openness to English, and in the case of Singapore and Malaysia, proficiency in Chinese. Switzerland has four official languages, not including an unofficial fifth, English, and Luxembourg three, again with English as an unofficial fourth. Ireland has two official languages, English being one of them. Singaporeans are educated in English, but the majority of the population is Mandarin-speaking. Equally, Malaysia's national languages are English, Mandarin, and standard Malay. Dubai may only have Arabic as a national language, but English is spoken widely due to the large expatriate communities where it is a first or second language.[8]

9.06 Although possibly resource poor, niche markets are people rich, even if some of the people have been imported. The diversity of languages, official and otherwise, in these niche markets is a proxy for their complexity and adaptability. At the economic and societal level,

[5] LIBOR is a collection of interest rates providing a measure of the cost of borrowing between banks. It is based on the rates at which banks lend each other unsecured funds on the London interbank market, and is given daily. LIBOR is determined by excluding the highest and lowest 25% of submissions, and then averaging the middle of the data. It is considered the most important global benchmark for short-term interest rates. In July 2012, regulators revealed that the rate had been manipulated by banks, allowing them to pass on higher borrowing costs, welfare losses and general distortions onto customers and the real economy. The manipulators' motives were varied, and included seeking profits on derivatives trades pegged to base rates as well as artificially lowering their cost of borrowing to appear less risky during the crisis. See Christopher Alessi and Mohammed Aly Sergie, 'Understanding the Libor Scandal', Council on Foreign Relations (5 December 2013) <http://www.cfr.org/united-kingdom/understanding-libor-scandal/p28729#p2>.

[6] As of 2013, Malaysia had a population of approximately 30 million people, followed by Switzerland with 8 million, Singapore with 5 million, Ireland with 4.5 million, Dubai with 2.1 million, and Luxembourg with 0.5 million.

[7] Although, arguably, some may have reaped the benefits of colonization. See eg Niall Ferguson, *Empire: How Britain Made the Modern World* (Penguin Group, 2004).

[8] There are an estimated 100,000 British expatriates in Dubai, the largest group among the non-Asian expatriates many of whom have English as a second language in addition to Urdu, Hindi, Persian, Bengali, Punjabi, Pashto, Malayang, Tamil, etc.

the local community, as diverse as it may be, provides stability,[9] but is also accommodating (if not exactly friendly) to the influx of non-locals who serve local purposes. Immigration, although temporary in many cases, flourishes, resulting in communities demonstrating a functional and almost medieval stratification. Dual, and triple, and more, economies operate. Education is valued, although not necessarily accessible to all, and technology embraced.

In addition to diversity of language and nationality, niche markets show high tolerance for legal pluralism, permitting the co-existence of quite different forms of law and a multiplicity of legal systems. The civil law jostles with the common law, international practices and a modern law merchant thrive;[10] local law and custom persist over centuries, sometimes peeking through colonial overlays. Switzerland excels at comparative law, putting legal concepts from multiple sources to work.[11] Islam and a very traditional form of imported common law can co-exist in Malaysia. A new legal system, providing international services, can be dropped in like a space station (complete with its denizens, the bankers, legal practitioners, and judges), as in Dubai. **9.07**

Niche markets can also engage in legal free-riding. Ireland and Luxembourg draw heavily on the dominant legal systems, common law and civil law, of their larger neighbours. Let London and Berlin do the heavy lifting in terms of developing codes and legislative frameworks, establishing law reform bodies and commissioning reports; the niche markets will continue with or appropriate the best of it and direct their energies to areas of specialization and value-added. They can focus and innovate. **9.08**

Nimbleness and opportunism are hallmarks of niche markets. They must innovate or perish. Tiny Luxembourg, for example, pioneered the first currency swap in 1981 for The World Bank and IBM, paving the way to the new world of derivative products. The Swiss Exchange was the first fully automated exchange in the world. The Stockholm exchange, now part of Nasdaq OMX, was the first exchange in the world to demutualize in 1993.[12] LuxSE had fully internationalized clearing and settlement in the 1960s and is still the leading European supplier of post-trading services in some 96 currencies in 54 markets worldwide. **9.09**

2.2 Niche markets and state capitalism

Niche markets appear in jurisdictions where governments nurture various forms of state capitalism. Macroeconomic policy and public funds support the creation of an international financial infrastructure in niche markets. The markets may be vibrant and dynamic, some if not all of the time, but market forces are subservient to the directing hand of the political masters (or, at the least, government and the market are holding hands). Government is the market's friend. The LuxSE notes the 'close collaboration between government, banks and corporations' in Luxembourg which results in 'efficient' decision-making; transactions will not be slowed down by bureaucracy.[13] **9.10**

[9] Bahrain would be a notable recent exception.
[10] See Cally Jordan, 'How International Finance Really Works' (2013) 7 *Law and Financial Markets Review* 256.
[11] For example, the Swiss Civil Code is a masterly combination of legal thinking from various sources and itself a model for other jurisdictions (such as Turkey).
[12] As a point of comparison, the NYSE did not demutualize until 2007.
[13] Luxembourg Stock Exchange, 'The Luxembourg Stock Exchange' <https://www.bourse.lu/luxembourg-stock-exchange> accessed 7 September 2013.

9.11 State-owned enterprises in various guises, advertent and accidental,[14] dot the financial services landscape in niche markets. In a country such as Switzerland, with two,[15] but only two, major international banks, these banks will not fail. In 2011, as the Swiss franc rose to levels threatening the balance and stability of Switzerland's economy, the Swiss National Bank (SNB) capped the currency. Niche market governments intervene. Relatively small local populations controlling the political process[16] facilitate the nimbleness. Despite sometimes large expatriate communities,[17] political decision-making resides in local hands. Political consensus can be achieved, albeit for different reasons in different places.[18]

9.12 Niche market governments are also international investors in their own right. Many, if not all, have sovereign wealth funds of various sorts.[19] Singapore has two, Temasek and GIC, the portfolio value of the former being some S$215 billion in 2013.[20] Malaysia has the Khazanah Nasional Berhad. The Investment Corporation of Dubai is a high profile international investor, sometimes too high profile for its own good.[21] Ireland has its National Pensions Reserve Fund. Even Switzerland may have a *de facto* sovereign wealth fund by virtue of the sizeable foreign reserve funds of the Swiss National Bank.[22] Tiny Luxembourg has no sovereign wealth fund per se, but provides branch office facilities for the others.[23]

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[14] During the global financial crisis, governments found themselves in the position of becoming shareholders in their financial institutions. In some jurisdictions the government will have a 'golden share' of some sort providing it with a lever to intervene in decision making. Often used in European economies during privatizations, Singapore and Indonesia, for example, have also created golden shares. On the other hand, it is a point of pride that golden shares have not been used in Switzerland.

[15] Credit Suisse and UBS.

[16] Again, Malaysia, with a population of approximately 30 million, is an outlier here.

[17] In Dubai, approximately 17% of the population is local, with the remainder being expatriates.

[18] In the case of Ireland, the rising tide of prosperity followed by the bitter consequences of economic failure, has produced political consensus whereas in Singapore and Dubai it is the result of authoritarian political regimes.

[19] The IMF defines sovereign wealth fund as: 'government owned investment funds set up for a variety of macroeconomic purposes. They are commonly funded by the transfer of foreign exchange assets that are invested long term overseas'. Robert Jenkins, 'Markets Insight: Swiss example questions need for QE unwinding', *Financial Times* (29 May 2013) <http://www.ft.com/intl/cms/s/0/d60a55ea-c774-11e2-be27-00144feab7de.html#axzz2eAm8D1cp> accessed 7 September 2013.

[20] Its initial value at its formation in 1974 was S$354 million. Temasek, 'Portfolio' <http://www.temasek.com.sg/portfolio/portfolio_highlights> accessed 7 September 2013.

[21] In 2006, the acquisition by one of its tiered subsidiaries of a British company owning significant portions of American port facilities was scuppered by American legislators. Although the subsidiary, Dubai Ports World, had complied with the appropriate processes and regulatory requirements, the House of Representatives cited national security concerns in voting to block the deal. Twenty-four hours after the vote, the firm decided to sell off its American port holdings. See Kevin W Lu, Gero Verheyen, and Srilal Mohan Perera, *Investing with Confidence: Understanding Political Risk Management in the 21st Century* (World Bank Publications, 2009), 75.

[22] Jenkins (n 19): 'Viewed as FX reserves, the SNB ranks fifth in the world. Viewed as a sovereign wealth fund, the holdings approximate those of China Investment Corporation. The Financial Times' front page recently reported Beijing's search for a new head of that wealth fund. Will a future edition announce the search for a chief investment officer of a newly created Swiss SWF?', *Financial Times* (29 May 2013).

[23] Indeed, it is marketed as the 'domicile of choice for the international investment structures of a number of sovereign wealth funds' (Ernst and Young, 'Luxembourg—the gateway for Islamic finance and the Middle East' (February 2013) <http://www.ey.com/Publication/vwLUAssets/Luxembourg_the_gateway_for_Islamic_finance_and_the_Middle_East/$FILE/Luxembourg-the-gateway-for-Islamic-finance-and-the-Middle-East.pdf>, 4, accessed 15 January 2014. Luxembourg may host sovereign wealth funds, but does not have one itself.

2.3 Niche markets and exchanges

Exchanges are the public face of niche markets; all the niche markets have them, sometimes several. The exchanges have been on the front line of the adaptive process.[24] Technology has been friendly to niche markets in this respect, creating new opportunities and overcoming, at least to a certain extent, isolation and the tyranny of distance. **9.13**

Niche market exchanges have targeted, or been created to serve, international markets; for the most part, their domestic markets are too small to sustain them.[25] The LuxSE, founded in 1928, is 'resolutely international in outlook',[26] calling itself the 'European exchange for international securities'. LuxSE hosts issuers from more than 100 countries.[27] The SIX Swiss Exchange advertizes itself as an 'internationally oriented and potent capital market', one which is 'more than a trading venue. Our appeal extends far beyond the borders of Switzerland'.[28] Singapore is the 'Gateway to Asia'. Dubai has created its own international exchange, 'Nasdaq Dubai', recycling the wealth that is awash in the Gulf region. Malaysia has positioned itself as the leading jurisdiction for Islamic finance, which potentially appeals to over a billion adherents around the world. **9.14**

In terms of financial products, issuers and investors, the niche market exchanges have adopted different strategies. The LuxSE has specialized in Eurobonds and Malaysia in Islamic financial products. Dubai has created an exchange with ambitions of international reach, recyling wealth from the Gulf region. Ireland has the LuxSE and Luxembourg's fund management business in its sights. The SIX Swiss Exchange, on the other hand, is a full service exchange, trading the whole gamut of financial products, either directly or through its subsidiaries and joint ventures; it is an independent 'reference market' for 'over 40,000 Swiss securities'. [29] The self-identified selling points of SIX Swiss Exchange are its depth (liquidity) and multi-asset platforms. SIX Swiss Exchange is also known, perhaps somewhat controversially, as a friendly place for high frequency trading.[30] Trading occurs on the SIX Swiss Exchange 'in a blink', with thousands of orders per blink.[31] **9.15**

Some niche market exchanges have not been swept up in the current waves of exchange mergers and consolidations.[32] Luxembourg had no interest in joining Euronext when it was **9.16**

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[24] Malaysia being the exception to this.

[25] Again, Malaysia may be the outlier here, but given that it is a developing economy, population size alone may not be sufficient to sustain a vibrant domestic market.

[26] Bourse de Luxembourg, 'A guide to 50 years of Eurobonds in Luxembourg' (12 May 2013), 11.

[27] 'Bourse de Luxembourg' <https://www.bourse.lu/home> accessed 16 January 2014.

[28] SIX Swiss Exchange, 'Welcome at SIX Swiss Exchange' <http://www.six-swiss-exchange.com/profile/profil_en.html> accessed 7 September 2013.

[29] SIX Swiss Exchange (n 28).

[30] SIX Swiss Exchange sometimes plays down its attractiveness to high frequency traders.

[31] SIX Swiss Exchange, '10,000 orders in 1 blink—on the world's fastest exchange' <http://www.six-swiss-exchange.com/news/overview_en.html?id=inet_colo> accessed 15 January 2014.

[32] Singapore failed in its attempt to merge with (or takeover, in the eyes of some Australian commentators) the Sydney exchange, the ASX. The Australian government refused to approve the transaction, dealing Singapore the 'national interest' card; Singapore had to fold its hand. The Australian Treasurer made his decision to block the merger and described it as a 'no-brainer': 'How the ASX-SGX merger failed', *Sydney Morning Herald* (21 April 2011) <http://www.smh.com.au/business/how-the-asxsgx-merger-failed-20110421-1dqb2.html> accessed 7 September 2013, saying that ASX 'operates infrastructure that is critically important for the orderly and stable operation of Australia's capital markets': Chris V Nicholson 'Australia Rejects Exchange Deal', *The New York Times* (8 April 2011) especially since it is the country's primary equities and derivatives exchange, as well as its sole clearing house for equities, derivatives, and bonds. He said that 'not having full

formed as a consolidation of the Paris, Brussels, Amsterdam bourses in 2000; this would simply have diluted its brand.[33] SIX Swiss Exchange (formerly SWX) in Zurich and Deutsche Bőrse in Frankfurt are very friendly, but no formal merger of the two exchanges is contemplated.[34] SIX Swiss Exchange advertizes itself as 'the most important *independent* exchange in Europe' (emphasis added).[35] Other niche market exchanges have looked to consolidations and mergers to survive and reposition themselves in a highly competitive exchange environment. Singapore took a run at Sydney. Bahrain's exchanges (as there are several, in a tiny country) are likely on the hunt for regional partners. Dubai's experiment in creating an international financial centre and an exchange to match, has been fraught; unable to survive on its own, the DIFX was annexed by NASDAQ and there may be further consolidation on the way.

9.17 Even without formal consolidations however, under the surface, alliances and interconnections exist. Until 1 January 2012, the SIX Swiss Exchange and the Deutsche Bőrse Group each held 50 per cent of EUREX, the world's largest futures and derivatives exchange. They are also partners in a new joint venture, 'Scoach', to provide a trading platform for derivatives products.[36] SIX Swiss Exchange boasts that its trading platform for equities is the fastest in the world;[37] it was developed by the US-Baltic exchange, NASDAQ OMX.[38] Although not formally a part of Euronext, in 2009 Luxembourg entered into a partnership with a Euronext subsidiary to develop trading platforms.[39] The Irish Stock Exchange (ISE) has an alliance

regulatory sovereignty over the ASX-SGX holding company would present material risks and supervisory issues impacting on the effective regulation of the ASX's operations, particularly its clearing and settlement functions': Nicholson (n 32). Some sources suggested, however, that one of the Australian Treasurer's primary concerns was the indirect 23% non-voting stake in SGX held by the Singapore government, although this was never stated publicly. See 'How the ASX-SGX merger failed', *Brisbane Times* (11 April 2011).

[33] LuxSE CEO has said that the exchange wishes to remain independent because, '[m]ergers between exchanges will not always bring more efficiency. An exchange facilitates capital formation and this comes from the ground up—from small and medium-sized enterprises—and the best interests of these companies may not always be served in a mega-merger. We believe that we can deliver better as an independent exchange': Bourse de Luxembourg (n 26), 12.

[34] Amongst other arrangements, on 25 October 2006, Deutsche Börse AG and SIX Group AG agreed in a cooperation agreement to combine their business operations in the area of structured products in a European exchange organization under a joint name and trademark (Scoach). This cooperation agreement was adopted by SIX Swiss Exchange AG in place of SIX Group AG on 24 March 2009: Deutsche Borse Group, 'Annual Report 2010' <http://deutsche-boerse.com/dbg/dispatch/en/binary/gdb_content_pool/imported_files/public_files/10_downloads/12_db_annual_reports/2010/10_complete_version/Annual_Report_2010.pdf> accessed 7 September 2013. However, the partnership unravelled in 2013, and SIX Swiss Exchange now operates the SIX Structured Products Exchange, formerly known as Scoach Switzerland.

[35] SIX Swiss Exchange, 'Regulation of short selling as part of self-regulation', Media Release (10 October 2013), 2, emphasis added <http://www.six-group.com/dam/about/downloads/media/media-releases/2013/1010-e-Short-Selling.pdf>.

[36] A response to crisis driven calls to improve transparency and security by moving derivatives trading to exchanges: SIX Swiss Exchange, 'Scoach: Five Eventful Years' <http://www.six-group.com/about/en/shared/news/2012/scoach.html> accessed 7 September 2013. DB, having acquired SIX Swiss Exchange's 50% share, is now the sole owner of Eurex. See Eurex, 'Corporate Structure' <http://www.eurexchange.com/exchange-en/about-us/corporate-overview/organizational-structure/139878/> accessed 7 September 2013.

[37] Matching trades in 37 microseconds: SIX Swiss Exchange, 'From 800 to 37 Microseconds' <http://www.six-group.com/about/en/shared/news/2012/from-800-to-37-microseconds.html> accessed on 7 September 2013.

[38] The second largest US equities exchange, itself a consolidated international exchange, OMX being a consolidation of Nordic exchanges.

[39] The Luxembourg Stock Exchange, 'NYSE Euronext Cooperation' <https://www.bourse.lu/luxembourg-stock-exchange-nyse-euronext> accessed 7 September 2013.

with the Deutsche Bőrse for trading ISE's equities on the German exchange's Xetra trading platform. Obviously, compatibility of electronic trading platforms permits cooperation and integration of operations across exchanges, irrespective of physical location or the formalities (and political bother) associated with merger or consolidation. One of the selling points for the (failed) merger of Singapore's SGX and Sydney's ASX was the compatibility of their trading platforms, provided by Nasdaq OMX.

Electronic trading is eclipsing traditional exchanges the world over, leaving the exchanges scrambling to find new relevancy, new product and service lines and new fee generation opportunities. Niche market exchanges have been at the forefront of these developments, given their proclivity for innovation and adaptability,[40] as well as their scramble to survive in some cases. SIX Swiss Exchange has an integrated vertical silo providing, through subsidiaries, the lucrative ancillary services of clearing and settlement, custody, share registry, payment systems, etc. LuxSE boasts that it has listed the first sukuk in Europe as well as the first French dim sum bond,[41] in addition to being the leading European supplier of post-trading services. LuxSE can settle in 53 currencies in 70 countries around the world.[42] **9.18**

2.4 Problems associated with niche markets

It is not hard to imagine the problems associated with niche markets. They can be vulnerable to change, as well as profiting from it. One misstep, one hesitation to adapt, and the combination of their small size and possible overspecialization can lead to near extinction.[43] Generalized market malaise may manifest itself in an acute form in niche markets. Niche markets tend to prize their reputations, yet small places are susceptible to cronyism and corruption, as Ireland has recently demonstrated.[44] **9.19**

Niche markets are fiercely competitive, but competitive pressures may also drive such markets under.[45] Their tax friendly environments may be attacked by the big economies intent on capturing tax revenues.[46] The tailored regulation and attentiveness to specialized **9.20**

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[40] For example, the SIX Swiss Exchange's high-frequency trading services (see n 37) or the former Scoach's platform for securitized OTC derivatives: SIX Swiss Exchange, 'SIX Swiss Exchange message no 17/2013' (15 March 2013) <http://www.six-swiss-exchange.com/swx_messages/online/swx_message_201305151012_en.pdf> accessed 15 January 2014.

[41] The first sukuk on a European exchange, issued by Malaysia Global Sukuk Inc (which is wholly owned by the Malaysian Ministry of Finance) and the first French dim sum bond were issued on 23 August 2002 and 19 September 2011, respectively. See Luxembourge Stock Exchange, 'History' <https://www.bourse.lu/luxembourg-stock-exchange-history> accessed 7 September 2013.

[42] PwC, 'The Luxembourg Stock Exchange—A prime location for Sukuk Listing' (2013), 2; Association of the Luxembourg Fund Industry, 'UCITS' (17 July 2013) <http://www.alfi.lu/setting-luxembourg/ucits> accessed 23 December 2013.

[43] Iceland is a prime example, as is Ireland. Dubai has also struggled in recent years, with a property bubble and potential collapse of Dubai World.

[44] Ireland, again, suffered the humiliation of a banking scandal as it was pulling out of its global financial crisis quagmire. In July 2012, three former Anglo Irish Bank executives were charged with unlawfully aiding a group of investors in buying its shares in 2008, thereby falsely inflating its share price before nationalization. Its CEO, Sean Fitzpatrick, was well known for his political connections, famously playing a round of golf with Ireland's then prime minister Brian Cowen a few months prior to the nationalization. See Linda Saigol and Jamie Smyth, 'The men behind the Anglo Irish Scandal', *Financial Times* (London and Dublin, 25 June 2013).

[45] Singapore and Ireland are two markets which are struggling.

[46] The tax friendliness of Ireland has been a political football in the United States for Google, for example.

market demands may spark allegations of 'race to the bottom' tactics.[47] Niche markets may create opportunities for regulatory arbitrage, frowned upon by other regulatory authorities.[48]

3. Distinctive Features of the Niche Markets

3.1 European niche markets—Luxembourg, Switzerland, and Ireland

9.21 Luxembourg and Switzerland, each for different reasons, are long-established international financial centres.[49] Each is centrally located within Europe, and giving the lie to the law and finance literature,[50] each is firmly within the European civil law tradition. Luxembourg, a country of barely half a million people, benefits from membership in the larger world of the European Union and, as a founding member, is home to EU institutions, the European Court of Justice and the European Investment Bank.[51] See Figure 9.1 (source: Bourse de Luxembourg (n 26), 4).

9.22 Switzerland, too, benefits from the European Union, albeit in a different way: it is not an EU member state, and so not constrained by the EU agenda set in Brussels. It is a careful line which the SIX Swiss Exchange treads, in affirming its commitment to harmonization with its EU neighbours, yet exploiting its differences as a competitive advantage.[52] Switzerland's prized neutrality has made it the home, not to EU institutions, but to international ones.[53]

9.23 Ireland is a latecomer to the European niche markets club, and one with a more troubled recent past. Still, having missed the first mover advantage captured by Luxembourg in the collective investment fund sector, Ireland has made a dramatic comeback and is now the world's fastest growing domicile for this market.

9.24 Tax incentives in all three countries, as in other international financial centres, act as a money magnet, attracting wealth generating industries and their service providers. A high level of creature comforts and good living assist. Luxembourg, Switzerland, and Ireland all provide an accommodating environment to high income asset managers and the clients they serve.

3.1.1 Switzerland

9.25 One of Switzerland's advantages, and one not shared by many niche markets, is its balanced economy, combining manufacturing and services. It has, of course, adroitly exploited its

[47] Chris Newlands, '"Lax" Luxembourg defends regulatory regime', *Financial Times* (26 May 2013) <http://www.ft.com/intl/cms/s/0/e0a51ce4-c47f-11e2-9ac0-00144feab7de.html#axzz2eAm8D1cp> accessed 7 September 2013.

[48] The mandate of the new European Securities and Markets authority specifically refers to deterring regulatory arbitrage (ESMA, 'ESMA in Short' <http://www.esma.europa.eu/page/esma-short> accessed 7 September 2013).

[49] Switzerland is the largest, with a population of nearly 9 million people to Luxembourg's 0.5 million.

[50] Which posits that common law systems produce more highly developed financial markets. See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W Vishny, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113.

[51] The European Investment Bank is the leading issuer listing on the Luxembourg exchange. See Figure 9.1.

[52] SIX Swiss Exchange openly avows its interest in harmonization.

[53] A large number of international organizations have based themselves in Switzerland, including a plethora of UN agencies and, most significantly, the Basel Committee on Banking Supervision as well as the more recently created Financial Stability Board.

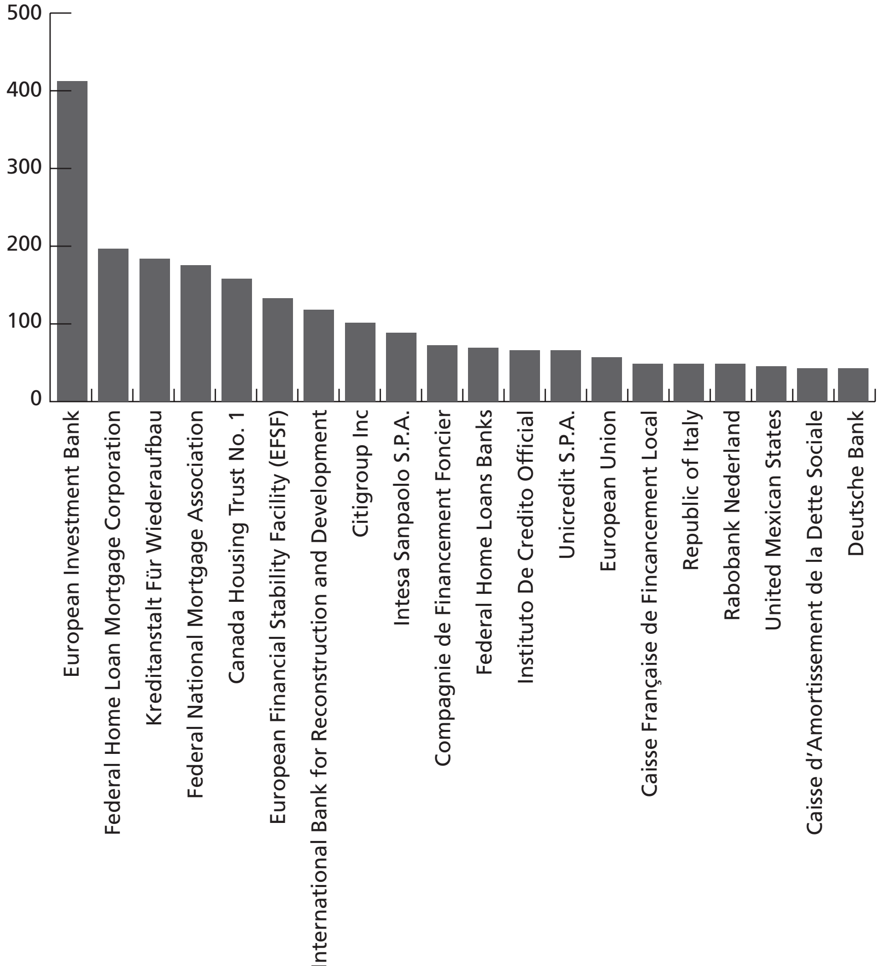

Figure 9.1 Top 20 Issuers by Outstanding Issue Amount in Luxembourg

political neutrality and, over decades, burnished its reputation for financial impeccability and discretion, a task which has lately proved challenging. Switzerland definitely looks outward to the larger international world, but maintains its domestic centre of gravity. Bern is the domestic exchange for Switzerland, whereas SIX Swiss Exchange is the international venue. Unlike LuxSE, which has pursued a successful strategy of specialization, SIX Swiss Exchange is a full service exchange, touting its depth, liquidity, and international outlook. Switzerland has the resources to indulge in the latest technology and has attracted high frequency trading for that reason. But Switzerland treads another fine line here. Providing opportunities for regulatory arbitrage with the European Union, mobilizing technology to attract trading, highlighting its attractive tax regime, all are tempting competitive strategies for Switzerland. The United Kingdom tightens its taxation of high income expatriates, and investment bankers pack their bags for Geneva and Zug. Publicly, though, these possibilities are downplayed. For the Swiss, reputation is all, a lesson which has not been lost on other niche markets.

3.1.2 Luxembourg and Ireland—the great rivalry

9.26 Tiny Luxembourg is home to one of the world's major capital markets, with the LuxSE as the leading European exchange for international bond listing with a market share of 42.1%,[54] and operating in 53 currencies.[55] Also, Luxembourg is a leader in cross-border investment fund activity, the world's second largest investment fund centre after the United States and the world's largest distribution centre for such funds.[56] The LuxSE is home to almost 4,000 collective investment funds, known as UCIs (Undertakings for Collective Investments), collectively managing €2.6 trillion.[57] Luxembourg's UCI industry is home to three-quarters of UCI funds distributed internationally and serves 70 countries.[58]

9.27 The global investment fund industry has traditionally grappled with a complex and fragmented regulatory environment.[59] While the UCITS regime was originally intended to serve the European Union as a single market, it has become the only true global standard in cross-border funds.[60] An increasing number of asset managers are establishing UCITS funds with a strategy for global distribution and Luxembourg is at the forefront of these trends. Luxembourg has been intimately involved in the growth of UCITS as a global brand and owes much of its success as a financial centre to this initiative. Luxembourg benefited from a first mover advantage as the first market to launch a UCITS fund in 1988.[61] Luxembourg was also the first country to implement the UCITS Directive into national law.[62] Moreover, there have been relatively frequent and substantial revisions to the UCITS vehicle and Luxembourg has stayed at the forefront, both by contributing to these changes and by implementing them quickly and efficiently.[63] Today, the country's UCITS funds alone represent 31.2 per cent of European UCI assets,[64] and three-quarters of all UCITS funds distributed internationally.[65]

9.28 The international funds business is the niche Ireland has targeted. The Luxembourg industry association takes pains to downplay the rivalry by saying that Luxembourg's strategy is not aimed at competing with Ireland. In particular, given that currently the unregulated alternative investment funds business must transition to a regulated industry under the Alternative Investment Fund Management Directive (AIFMD) in the European Union, Luxembourg argues that enough new business will be generated for both countries to share.[66] One factor is that AIFMD will force foreign fund houses to establish offices in Europe as it will be easier to comply with the regime from closer proxmity.[67]

[54] PwC, 'The Luxembourg Stock Exchange—A prime location for listing' (2012), 3.
[55] PwC (n 54), 2.
[56] Association of the Luxembourg Fund Industry, 'Luxembourg: The Global Fund Centre' (2012–13), 3 <http://www.alfi.lu/sites/alfi.lu/files/Luxembourg-the-global-fund-centre.pdf> accessed 15 January 2014.
[57] Ernst & Young, 'Investment Funds in Luxembourg—A technical guide' (September 2013), 5.
[58] Association of the Luxembourg Fund Industry (n 42).
[59] 'Investment Funds in Luxembourg' (n 57), 8.
[60] Spence Johnson, 'Trends in Cross Border Distribution' (September 2012), 6.
[61] Johnson (n 60), 6.
[62] Association of the Luxembourg Fund Industry (n 56) 11.
[63] Association of the Luxembourg Fund Industry (n 56), 13.
[64] Association of the Luxembourg Fund Industry, 'An Overview of the Luxembourg Fund Industry', PowerPoint Presentation (2012), 2.
[65] Association of the Luxembourg Fund Industry (n 56), 2, 11.
[66] Ellen Kelleher, 'Luxembourg could strike fund gold again', *Financial Times* (3 February 2013).
[67] Kelleher (n 66).

Compared to Luxembourg and Switzerland, Ireland is an upstart as an international financial centre. Despite Luxembourg's first mover advantage on UCITS, Ireland was quick off the mark. As a result, between 2000 and 2010 total fund assets domiciled in Ireland grew at an average annual rate of 17 per cent compared with Luxembourg's 10 per cent.[68] Today, Dublin is the world's largest administration centre for hedge fund and alternative managers, with more than 40 per cent of global hedge fund assets being serviced there.[69] And Ireland continues to be the fastest growing UCITS domicile in the world.[70] 9.29

In fact, Ireland has been so successful in establishing itself in the financial services industry, that it has proven a stabilizing force during turbulent economic times for Ireland. The Irish markets experienced serious and well-publicized difficulties. In part, Ireland was touched by the generalized instability and uncertainty of the Eurozone debt as well as economic difficulties of its own making. But financial services have continued to shine. 'Ireland has been through a very tough period in the past few years; we have grounds to be optimistic now on a number of fronts but in financial services the one constant has been the funds industry. The industry continues to create employment, to showcase our talents and to enhance Ireland's reputation as a place to do business.'[71] 9.30

Unlike the United Kingdom, Ireland enthusiastically embraced the European Union, and has profited mightily by the relationship. Despite Ireland's choice of investment funds management as its niche putting it on a collision course with Luxembourg, Ireland was remarkably successful in a short period in positioning itself as a fund destination. It created a developed fund infrastructure, enticing participants with low taxes. For example, Ireland's capital gains tax rate fell from 60 per cent in 1985 to 20 per cent in 2001 and its corporate tax rate fell from 50 per cent to 16 per cent in the same years.[72] 9.31

The MiFID structure for financial services provided Irish funds with easy access to the rest of Europe. However, the crucial EU instruments for Irish purposes have been the UCITS Directives which created a European passport for certain types of securities. Ireland implemented the UCITS Directive early on and has paid close attention to its updating. Finally, Ireland invested in its people, turning an educated and English-speaking population into legions of professionals such as accountants, listing brokers, and lawyers, all of whom form the infrastructure of a financial niche.[73] The result was that funds flocked to set up shop in Ireland; as of 2013, over 12,000 funds are domiciled in Ireland.[74] 9.32

Implementing EU directives is one thing; maintaining the regulatory domestic underpinnings is another. EU directives float on top of the domestic legal system, exerting their 9.33

[68] Marie Lindsay, 'Luxembourg and Ireland remain competitive jurisdictions for UCITS hedge funds', *Hedge Funds Review* (30 September 2011).

[69] David Ricketts, 'Luxembourg's bid for the alternatives', *Financial Times* (2 May 2010).

[70] Matheson, 'Ireland and Luxembourg—a comparison' (30 April 2013) <http://www.matheson.com/images/uploads/publications/Ireland_and_Luxembourg_WEB_May_13.pdf> accessed 15 January 2014.

[71] Mr Michael Noonan, Irish Minister for Finance, 12 June 2013 <http://www.irishfunds.ie/fs/doc/publications/ifia-presentation-tokyo-english.pdf> accessed 23 December 2013.

[72] Marc C Duff, 'Ireland's Economic Progress: on the verge of bankruptcy to economic star of Europe in 5 years' (October 2003), Tax Payers Network, <http://www.taxpayersnetwork.org/_Rainbow/Documents/Irelands%20Economic%20Progress.pdf> accessed 23 December 2013.

[73] Irish Funds Industry Association, 'Why Ireland?' <http://www.irishfunds.ie/why-ireland/> accessed 23 December 2013.

[74] Irish Funds Industry Association (n 73) .

harmonizing influences. Ireland, like the United Kingdom and unlike the rest of the European Union, is a common law jurisdiction. For historical and other pragmatic reasons, Irish legislation and institutions very much follow the UK lead. Of late, the United Kingdom has been undergoing great regulatory and institutional change in financial services. Repeated reglatory and institutional overhauls are costly, and potentially disastrous, even in large markets such as the United Kingdom.[75] They are particularly worrisome in small markets such as Ireland, where resources are fewer and the financial system less resilient. In the case of Ireland, it has been the price to pay for dancing to the United Kingdom's legislative and regulatory tune.

3.2 Singapore and Malaysia

9.34 The modern city state of Singapore was born in 1965 when Malaysia and Singapore parted company after a shortlived relationship. The Chinese population, a minority in Malaysia as a whole, formed a majority in the new Singapore. The shared colonial history of Singapore and Malaysia, however, has left behind the legacy of the common law. Although both countries have followed different paths in the ensuing years, both have been able to look to London (although not exclusively to London) to continue to provide the conceptual bases of their financial and legal systems. Within that context, they have forged their own way. A strong form of British colonial law and institutions has persisted in Malaysia, adapted by and adapting to, its Islamic majority population.[76] English law and institutions are also still readily discernible in Singapore, but much influenced by uniquely Singaporean initiatives and idiosyncrasies. Unlike Malaysia, Singapore is more interested in China[77] and Hong Kong, rather than Islam.

3.2.1. Malaysia

9.35 Malaysia is somewhat of an outlier in this discussion of niche markets. It has a relatively large population of 28 million people and a fairly diversified, resource rich economy including a vibrant oil and natural gas industry. Additionally, Malaysia, unlike some of the other niche markets under consideration, would still be considered an emerging economy, although this concept itself is somewhat outdated. Malaysia's particular niche, Islamic finance, also fits somewhat uneasily in the 'niche' category; it is geographically widespread and growing rapidly in importance.

9.36 Nevertheless, Malaysia has adopted, and further developed, niche market strategies. It has recognized the potential which internationalization presents for its domestic economy. The Malaysians are not shy about state capitalism either and the government is an active initiator of economic activity. There is a special offshore financial centre with its own regulator,

[75] There were concerns that the regulatory overhauls of the 2008–13 period in London in response to the global financial crises would sow disarray in the markets and permit serious regulatory lapses. However, the dismemberment of the Financial Services Authority into two regulatory bodies, the FCA and the PRA, proceeded fairly smoothly once the direction of regulatory reform had been settled. The cynical might say that was because not much changed, with the FCA picking up, albeit with a more limited jurisdiction, where the FSA left off. Personnel stayed in their offices, the email address may have changed from 'FSA' to 'FCA', but otherwise, everyone carried on.

[76] The process of British colonization usually did not displace local law and custom; the English common law, as introduced, floated on top of it.

[77] Because it is such a direct comparator and traditional rival.

LOFSA, the Labuan Offshore Financial Services Authority. As in other niche markets, Malaysia has created specialized market segments and parallel regulation, similar in general structure, differentiated at the margins, interlinked and generally compatible. Keeping a keen eye on international developments in capital markets, Malaysia has been an early adopter of international financial standards and has assumed a leading role in IOSCO. But the big story in Malaysia, the niche where it has had the greatest impact, is Islamic finance.

Islamic finance Islamic finance holds about a 1 per cent share of the global market. **9.37** However, that represents an industry worth up to US$1.3 trillion and growing nearly 20 per cent annually, sukuk, bonds, being the driving force. Islamic financial institutions are now a global presence, with offices in the major world capitals. Certain characteristics of Islamic finance permitted it to weather well the recent global financial crisis (not to mention the Asian crisis of 1998).[78]

Islamic finance, like Islam itself, is characterized by its diversity, its internal divisions and **9.38** disputation centring around its various schools of thought. Nevertheless, two main streams of Islamic finance are usually identified, that of the Middle East (represented by Saudi Arabia, Bahrain, Qatar, and Dubai), and that of Southeast Asia (primarily Malaysia and Indonesia).[79] The conventional view, although somewhat controversial, is that the Southeast Asian version is more flexible when it comes to Sharia compliance, something Malaysia is eager to play down.[80]

Malaysia has taken the lead in Islamic finance in Southeast Asia, although neighbouring **9.39** Indonesia, with the largest Islamic population in the world, has positioned itself as a contender.[81] Malaysia though is still the undisputed leader, having one of the most developed Islamic financial systems in the world, as well as the largest trading market in Islamic bonds, the sukuk.[82] Malaysia dominates the global sukuk market, having issued three-quarters of global issuance in 2012 after having issued the world's first sovereign sukuk in 2002.[83] These are remarkable achievements for a country of less than 30 million people, 60 per cent of whom are Muslim. Neighbouring Indonesia, with the world's largest Muslim society—80 per cent of a population of 240 million people—only has 4 per cent of its banking assets in Sharia compliance.[84]

Islamic capital markets are 'ideally characterized by the absence of interest based transac- **9.40** tion, doubtful transactions and stocks of companies dealing in unlawful activities or items'. Capital markets are 'one of the [most] important and growing segments in Islamic Finance'.[85] The future is bright for Malaysia and Islamic finance; projections for financial sector growth

78 Jon Gorvett, 'Which Way Forward for Islamic Finance?' (July 2012) *Middle East* 35.
79 Gorvett (n 78).
80 Gorvett, (n 78).
81 Kevin Brown, 'Malaysia: Ahead of the game in local contest', *Financial Times* (12 May 2010).
82 'Banking on the ummah: Malaysia leads the charge in Islamic finance', *The Economist* (5 January 2013).
83 'Banking on the ummah' (n 82).
84 'Banking on the ummah' (n 82).
85 Wan Razazila Wan Abdullah, Jamal Roudaki, and Murray Clark, 'The Evolution of the Malaysian Islamic Capital Market: Towards a Global Hub', from the AFAANZ Global Conference (2010) <http://www.victoria.ac.nz/sacl/about/events/past-events2/past-conferences/6ahic/publications/6AHIC-75_FINAL_paper.pdf> accessed 4 February 2013, 1, citing SO Alhabshi, 'Development of Capital Market Under Islamic Principles', Paper presented at the Conference on Managing and Implementing Interest Free Banking/Islamic Financial System (1994).

run at 'a buoyant pace by 8–11% per annum', expanding its share of Malaysia's GDP, 'from 2.4 times to 3 times by 2020'.[86]

9.41 **Malaysian capital markets and their preeminence in Islamic finance** The preeminence of Malaysian capital markets in Islamic finance has largely been attributed to 'state nurturing'.[87] Through state leadership and backing, Islamic finance in Malaysia increased to 22 per cent of the country's banking sector in 2011, up from 6 per cent in 2001.[88] Impressive government policy making and planning appear in the *Financial Sector Blueprint of 2011–2020* and the *Economic Transformation Programme*.[89] Malaysia is now beginning to open up its Islamic finance sector to large Islamic banking conglomerates, as well as to multi-national, and even western, Sharia-compliant, banking institutions.

9.42 Currently, the conventional (ie non-Islamic) and Islamic components of capital markets in Malaysia function side by side, with similar regulatory schemes for each. Additional sets of requirements are layered over the conventional finance infrastructure 'to ensure the Islamic products and services are Sharia-compliant'.[90] The Shariah Advisory Council, made up of both financial and Sharia experts, makes the call on compliance, centralizing the process and obviating the need for institution by institution review processes as exist elsewhere. Islamic financial and banking products now dominate the domestic Malaysian market. 'Sharia-compliant securities amounted to RM1.16 trillion at the end of 2011, accounting for 54.4 per cent of the entire capital market. Of the securities listed on Bursa Malaysia Securities, 89 per cent are deemed to be Sharia-compliant. Malaysia is the biggest sukuk market in the world, with RM349.0 billion in outstanding ringgit-denominated sukuk as at the end of 2011, accounting for approximately two-thirds of global sukuk outstanding.'[91]

9.43 In fact, the conventional and Islamic markets are so linked, and have worked so well in parallel, that the International Monetary Fund (IMF) 'does not distinguish between conventional and Islamic markets with respect to expectations or standards'[92] in its assessment methodology. The IMF has also found that, although there are 'some areas where enhancements are advisable', the Securities Commission of Malaysia, 'as the supervisor of the capital markets, has developed a robust supervisory framework that exhibits high levels of *i*mplementation of the . . . IOSCO Principles . . . in most areas. The regimes governing the regulation of issuers, auditors, collective investment schemes, market intermediaries and secondary markets, and with respect to enforcement, co-operation and information sharing, are extensive'.[93] The IMF's assessment reaffirms the maturity and extensiveness of Malaysia's Islamic capital market at the policy level, concluding that Malaysia is now a leader both in the Islamic financial sector and in the global securities market as a whole.

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86 PwC, 'Getting the Picture: Malaysia's Financial Sector Blueprint, Strengthening our Future 2011–2020' (February 2012) <http://www.pwc.com/en_MY/my/assets/publications/fsb-msia_1march2012.pdf> accessed 12 September 2013.
87 Gorvett (n 78).
88 Gorvett (n 78).
89 PwC (n 86).
90 International Monetary Fund, 'Malaysia: Publication of Financial Sector Assessment Program Documentation—Detailed Assessment of Implementation of IOSCO Objectives and Principles of Securities Regulation' (IMF Country Report No 13/59/, 2013), 15.
91 International Monetary Fund (n 90).
92 International Monetary Fund (n 90).
93 International Monetary Fund (n 90), 6.

Promoting Islamic finance as its niche has proved to be a brilliant strategy for Malaysia. Tapping into a neglected but truly international market has invigorated Malaysia's domestic markets, as well as bringing it recognition as a leader internationally. Malaysia identified the factors impeding the growth of Islamic finance such as the lack of standardized products, the costly procedures associated with structuring them, the absence of Islamic specific regulatory and accounting frameworks. Malaysia then proceeded to draw upon techniques developed in the conventional international capital markets to address these problems. **9.44**

There is an increasingly robust international institutional framework for standard-setting which serves to address the problems stemming from lack of standardization. Inspired by the International Accounting Standards Board (IASB), the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established in Bahrain by Islamic financial institutions in 1991.[94] AAOIFI regularly issues accounting, auditing, and governance standards for Islamic financial institutions as well as Sharia standards. Thus the AAOIFI aims to achieve harmonization and convergence in the concepts and application among the Sharia supervisory boards of individual Islamic financial institutions so as to avoid contradiction or inconsistency between the *fatwas* and applications by these institutions.[95] Malaysia is a prime proponent of AAOIFI; 'the universe of Islamic finance contracts applied in the Malaysian Islamic finance sector embraces all opinions of the AAOIFI'.[96] **9.45**

Another international body, the Islamic Financial Services Board (IFSB), somewhat analogous to IOSCO, is an 'international standard setting body of regulatory and supervisory agencies'[97] and its objective is to promote the 'development of a prudent and transparent Islamic financial services industry through introducing new, or adapting existing, international standards consistent with Sharia principles'.[98] Malaysia established the IFSB, situated in Kuala Lumpur, by national legislation, the Islamic Financial Services Board Act 2002. The IFSB has nearly 200 members, in 39 jurisdictions,[99] including central banks, international multilateral institutions such as the IMF, The World Bank and Bank for International Settlements, and financial institutions.[100] **9.46**

Malaysia was also one of the founding members of the International Islamic Financial Market (IIFM), another international Islamic finance standard setter, a 'standard setting organization focused on the Islamic capital and money market segment of the industry'.[101] IIFM, in a manner similar to that of ISDA (the industry association for the international swaps and derivatives markets), focuses on standardizing Islamic financial products, documentation and related processes. **9.47**

94 Nicholas HD Foster, 'Islamic Finance Law as an Emergent Legal System' (2007) 21 *Arab Law Quaterly* 170, 179

95 Foster (n 94), 179.

96 Kabir Hassan and Michael Mahlknecht, *Islamic Capital Markets: Products and Strategies* (Wiley Finance Series, 2011), 325.

97 See the IFSB website: <http://www.ifsb.org/background.php> accessed 23 December 2013.

98 See the IFSB website (n 97).

99 Oxford Analytica comment, 'Islamic Finance Moves Towards Common Standards', *Forbes* (9 March 2010) <http://www.forbes.com/2010/03/08/islam-finance-sharia-business-oxford-analytica.html> accessed 23 December 2013.

100 Foster (n 94), 179.

101 See IIFM website <http://www.iifm.net> accessed 23 December 2013.

9.48 Finally, the Shariah Advisory Council (SAC) of Bank Negara Malaysia, the country's central bank, acts as the highest Sharia authority for Islamic finance in Malaysia and is responsible for both determining Islamic law for the purposes of Islamic finance and for validating all Islamic finance products to ensure their compatibility with Sharia principles.[102] Indeed, 'the Shariah standards of the Shariah Advisory Council of Malaysia incorporate all the Shariah interpretations of the AAOIFI'.[103] Thus, Malaysia's intimate role in the international standard-setting of Islamic finance has been pivotal to its success in becoming the world's centre for Islamic finance. Other initiatives by the Malaysian government have helped the country to carve out this niche. Two institutions set up by Bank Negara Malaysia are of particular importance. First, the International Centre for Education in Islamic Finance (INCEIF), established in 2005, is the world's leading university for Islamic finance drawing its students from 80 countries. Within the INCEIF is the International Sharia Research Academy where scholars formulate an international rule-book for Islamic finance.[104] Secondly, the Islamic Banking and Finance Institute of Malaysia (IBFIM) assists financial institutions in becoming Sharia-compliant through consulting services and certification in Islamic finance.[105]

9.49 Social and political factors, prompted by economic disparities along ethnic lines, played a role in government-led initiatives to establish Islamic finance in Malaysia.[106] IOSCO has identified other triggers: 'two main reasons that have been identified to support the emergence of the Malaysian Islamic Capital Market are the 1997 Asian Financial Crisis and the liquidity problem resulting from surplus funds from the Islamic finance industry'.[107] The Malaysian government acted to deter future financial upheavals.[108] Malaysia began to pay close attention to its regulatory framework and its markets. Incentives promoted the development of both the Islamic financial sector and the regulators.[109] This was state capitalism, but one well attuned to the markets and supported by a strong form of common law and institutions. Building on conventional finance, tweaking and adapting it to Islamic principles and the characteristics of the market were fundamental. In particular, Malaysia recognized the international nature of Islamic finance and drew on international experience. And, importantly, there was a nascent market; it just needed a little watering.

[102] See SAC website <http://www.bnm.gov.my/index.php?ch=7&pg=715&ac=802> accessed 23 December 2013.

[103] Hassan and Mahlknecht (n 96), 325.

[104] 'Banking on the ummah' (n 82).

[105] 'Banking on the ummah' (n 82).

[106] Wan Abdullah, Roudaki, and Clark (n 85), 27. 'Initiatives taken by the Malaysian government towards a global hub are substantial. Every perspective, such as product innovation, infrastructure facilities, policy incentives, human capital development, liberalisation and regulatory framework are being well focused. All parties either the regulatory bodies or the market players are involved to ensure the achievement of an international hub for an Islamic Capital Market.'

[107] Wan Abdullah, Roudaki, and Clark (n 85), 1.

[108] Although strongly criticized at the time of the Asian financial crisis for imposing exchange controls, Malaysia's intervention in the market was subsequently vindicated.

[109] '[T]he scope of jurisdiction for these regulating bodies encompasses both Islamic and conventional finance matters. Malaysia's banking and insurance sectors come under the jurisdiction of the Central Bank, Bank Negara Malaysia (BNM) while the capital market is regulated by the Securities Commission Malaysia (SC). Matters related to offshore finance industry are regulated by the Labuan Offshore Financial Services Authority (LOFSA)': Wan Abdullah, Roudaki, and Clark (n 85), 2

3.2.2 Singapore

Singapore, the Lion City, fits the niche market profile in terms of size, geographic location (a hinterland rich in opportunity), openness to trade and commerce, richness of human resources, and ease of implementing government-led market and regulatory initiatives. For Singapore, the problem has been finding the niche. Granted, Singapore is Asia's largest overseas market for Asian equity futures (focusing on China, India, and Japan). With the advent of real estate investment trusts (REITs) in 2002 and business trust structures in 2004, the Singapore exchange, SGX, has also established itself as the Asia-Pacific region's largest exchange for REITs.[110] But Malaysia has outmanoeuvered Singapore by commandeering Islamic finance. And despite the recent appearance in Singapore of Rmb-denominated 'lion bonds'[111] and 'S-chips',[112] Hong Kong has secured its own position as the gateway to China. **9.50**

Looking to London, Singapore sees itself as a primarily international trading venue with a focus on foreign listings. Already, 40 per cent of the approximately 800 listed companies in Singapore are non-domestic, more than half of which are from outside China. However, this may disguise a more fundamental problem with the market. Singaporeans themselves are not particularly interested in equity investing; they prefer to punt on property. In looking for growth, Singapore has targeted the regional Asian markets with the ambition of becoming the 'gateway to Asia' (ex-China and ex-Japan) for Europe. However, other Asian markets, in countries like Indonesia or Vietnam, are becoming feisty in their own right. And Singapore recently suffered an embarassing setback in a growth by acquisition strategy, when the Ausralian government scuppered a friendly merger with the ASX in Sydney. **9.51**

Singapore has many niche market advantages nevertheless: its strategic geographic position between Asia and Europe (coupled with an orchid-filled airport); a strong tradition of common law and English-style financial institutions; an English educated, majority Mandarin-speaking population; a plethora of financial and legal advisers; tax incentives for both individuals and businesses; a political system which can respond quickly and directly to change; and an intolerance for corruption. **9.52**

Increasingly, Singapore has become a playground for the rich, the Switzerland of Asia.[113] Let Hong Kong handle the massive flotations for the Chinese state-owned enterprises; when it comes time to stash away the profits, Singapore is eager and waiting. Singapore strives to be a hub; economic, legal, scientific, artistic. It is a player and, consequently, for anyone looking to do business in Asia, Singapore is a serious contender. With a top tax bracket of 15 per cent, the wealth managers have poured in together with the wealthy, the hedge funds and the multinationals. Singapore therefore strives to remain as stable, low-cost and efficient as possible.[114] **9.53**

[110] Shirlene Tsui, 'SGX—A prescription for growth', *Wall Street Journal* (New York, 14 March 2011) <http://blogs.wsj.com/exchange/2011/03/14/sgx-a-prescription-for-growth/> accessed 12 September 2013.

[111] Bonds denominated in renminbi, mainland Chinese currency.

[112] S-chips are mainland Chinese companies with securities listed on the Singapore Stock Exchange (SGX). The problem with S-chip companies has been their inferior quality, leading to delisting or being placed on a watch list by the SGX.

[113] The attractions are secure property rights, political stability, independence, and centrality in ASEAN, the region set to become the world's largest economic region.

[114] However, fostering a dual economy always runs the risk of local backlash against the expatriate community. In 2012, the *Straits Times*, Singapore's main newspaper, ran a few articles questioning the need for so many expatriates, lamenting the lack of high paying and quality jobs for Singaporeans and the increasing cost

9.54 **Development of Singapore's capital market** The story of capital markets regulation in Singapore begins in1973 with the passage of the Securities Industry Act[115] which created the Stock Exchange of Singapore (SES, a predecessor to the current SGX) and the Securities Industry Council (SIC). In the English tradition, at that time, the SES was largely self-regulatory.[116]

9.55 In 1985, the 'Pan-El Crisis' profoundly shook both the Singaporean and Malaysian markets. Pan-Electric was a Singapore-listed company with 71 subsidiaries and a market capitalization of approximately $200 million. When Pan-Electric unexpectedly went into receivership both the Singapore and Malaysian stock markets had to shut down. Singapore responded with a new Securities Industry Act in 1986 and progressively adjusted its financial regulatory framework in the period leading up to the Asian financial crisis of 1997.[117] The calibration continued apace as the Asian financial crisis subsided, culminating in the current Securities and Futures Act of 2002 (the SFA).[118]

9.56 The regulatory framework and institutions in Singapore demonstrate a strong British imprint, of the older variety. The central bank, the Monetary Authority of Singapore (MAS), has ultimate oversight of financial markets while the exchange, the SGX, does the heavy lifting, operating as a self-regulatory organization.

> Under the present regulatory scheme, the Monetary Authority of Singapore ('MAS') supervises the securities industry.[119] It has less oversight of an exchange's disciplinary procedures and rule changes. The day to day supervision of the market is still left with the SGX. The internal management of the SGX is regulated by its Memorandum and Articles of Association. Trading in securities is regulated by the SGX Rules. The criteria for listing and the obligations of listed companies are found in the SGX Listing Manual.[120]

9.57 MAS is a powerful, centralized regulator,[121] specifically charged with maintaining Singapore as a sound and reputable financial centre. A separate, and equally important, mandate is to promote Signapore as an international financial centre.[122] In addition to administering financial legislation and creating a supporting regulatory framework, MAS has a number of other instruments in its regulatory arsenal, both coercive and persuasive. Directions, which 'detail specific instructions to financial institutions or other specified persons to ensure

of living. Additionally, there was a public outcry when a mainland Chinese ran his Ferrari through a taxi, killing all involved.

[115] Securities Industry Act 1973 (No 17 of 1973).

[116] Walter Woon, 'Regulation of the Securities Industry in Singapore' (1994) 4 *Pacific Rim Law and Policy Journal* 731.

[117] Professor Hans Tjio and Rachel Eng, *Corporate Finance and Securities Regulation* (Singapore Academy of Law Ed, 2012), para 17.1.2.

[118] Securities and Futures Act 2002 (Ch 289) (2002).

[119] Within the MAS, the Financial Supervision Department looks after capital markets regulation as one of its three units, the two others being Banking and Insurance and Policy, Risk and Surveillance. The Capital Markets unit handles enforcement, markets and infrastructure supervision as well as policy matters. The Policy, Risk and Surveillance unit conducts economic surveillance and develops 'prudential policy'. MAS thus operates as an integrated financial services regulator. Monetary Authority Singapore, 'Monetary Authority Singapore Organizational Chart' (2013), <http://www.mas.gov.sg/about-mas/overview-of-mas/organisation-chart.aspx> accessed 12 September 2013.

[120] Tijo and Eng (n 117), para 17.1.2.

[121] Monetary Authority of Singapore Act (Ch 186) (1999).

[122] Monetary Authority of Singapore Act (Ch 186) (1999), s 4(2)(d).

compliance', permit MAS to attach criminal sanctions. MAS also sets out 'principles or "best practice standards" that govern the conduct of specified institutions or persons' which do not create civil or criminal liability but which assist MAS in its risk assessments. Very much in keeping with English tradition, Singapore also makes use of 'voluntary codes', the Takeover Code,[123] a Code on Collective Investment Schemes,[124] and a Code of Conduct for Credit Rating Agencies.[125] Because they are non-statutory, these codes rely on reputational forces for their traction.[126] A breach of a code obligation may result in a private tap on the wrist by MAS or public naming and shaming. In addition, there are also an assortment of practice notes, circulars and policy statements, none with coercive effect, but useful for informational purposes given the cryptic nature of the legislative instruments. Again, in the English tradition, the Securities Industry Council (SIC), first created in 1973 and composed of bankers, legal experts, MAS staff and other industry experts, advises the Minister for Finance. In addition, the SIC administers the Takeovers Code.

The Singapore Exchange (SGX) Singapore is best known in world capital markets for its exchange. The Singapore Exchange (SGX) was established in December 1999 as an investment holding company after consolidating former exchange companies, namely the Stock Exchange of Singapore, the Singapore International Monetary Exchange and Securities Clearing and Computer Services. SGX offers securities, fixed income, derivatives, and commodities products as well as a suite of services including clearance, settlement and depository, and over-the-counter clearing for oil swaps and forward freight agreements. These are supported by a robust technical infrastructure for market data and access. **9.58**

As in London prior to the creation of the Financial Services Authority (FSA) in 2000, the stock exchange is a front line regulator in Singapore, albeit under the watchful eye of the MAS. As with other modern, demutualized exchanges, SGX is a company limited by shares and has adopted a variety of regulatory approaches,[127] combining the disclosure based regulation of the United States with the risk based targeting pioneered by the FSA in London. With its ambitions to be an international trading venue, the SGX pays attention to international standards and best practices, but always tailored to idiosyncratic Singaporean ways. **9.59**

Exchanges worldwide are an endangered species, looking for new ways to survive; SGX is no exception. On 1 May 2013, SGX began a restructuring process.[128] The proposed merger of the SGX with the ASX in Sydney was another high profile survival strategy, but one which met with failure. SGX, in headlong competition with Hong Kong, was looking for growth potential. Singapore and Hong Kong—two of the region's financial hubs—have been trying to **9.60**

[123] Code on Take-Overs and Mergers (Monetary Authority of Singapore Ed, 2012).

[124] Code on Collective Investment Schemes (Monetary Authority of Singapore Ed, 2011).

[125] Code of Conduct for Credit Rating Agencies (Monetary Authority of Singapore Ed, 2012).

[126] Reputational forces can be quite powerful in a small place.

[127] Singapore Exchange, SGX, 'Regulatory Approach, Philosophy and Guiding Principles' (2013).

[128] Its operations were divided into five business units: Derivatives, Listings, Market Data and Access, Post-Trade, and Securities. SGX said in a statement that these units, 'with the support of the sales and client unit, will collectively drive the expansion of the products and services suite, the attraction of more and larger listings, the growth of retail and professional participation, and the building of the post-trade business'. Jakes Thomases, 'SGX faces a resignation and a restructuring', *Waters Technology* (28 March 2012) <http://www.waterstechnology.com/sell-side-technology/news/2164385/sgx-resignation-restructuring> accessed 12 Septermber 2013.

'outmaneuver one another in pursuit of new listings and investor cash'.[129] The two economies are competitive, open, and approximately the same size. And yet, SGX is a fraction of the size of its Hong Kong counterpart, raising only one-ninth the amount of capital, offering one-third the amount of liquidity and trading less than one-fifth on average per day.[130] This competitive state of affairs propelled SGX to seek growth via the mergers and acquisitions route.

9.61 It is within this context that SGX's proposed US$8.3 billion cash-and-shares offer for ASX was announced in October 2010,[131] under the slogan 'Asia Pacific—the heart of global growth'.[132] ASX-SGX Ltd, to be listed on both the Australian and Singaporean exchanges, would have been the fifth largest exchange group in the world, offering access to 2,700 listed companies from 20 countries—including over 900 resource firms and the largest number of real estate investment trusts and exchange-trade funds[133]—and boasting a combined market capitalization of US$12.3 billion.[134] It would also have been the second-largest in the Asia-Pacific region by market value (after Hong Kong) and second in the Asia-Pacific by number of listings (after India).[135]

9.62 From the Singaporean perspective, this was a tempting prospect. For numerous reasons, SGX and the ASX were widely regarded as highly compatible exchanges for the purposes of a merger. Economically, the Asia-Pacific region is growing and there is increasing competition to provide the most liquid portfolio of financial products.[136] Both exchanges are powered by Nasdaq OMX's Genium INET trading technology permitting creation of a single, multi-asset platform with a single access point in the region, reducing trading costs and increasing technical efficiencies.[137] Despite these persuasive arguments, the Australian Treasurer rejected the merger proposal; SGX and ASX mutually terminated the agreement and SGX stated that it would 'continue to pursue organic as well as other strategic growth opportunities, including further dialogue with ASX on other forms of cooperation'.[138] Putting on a brave face, SGX CEO Magnus Bocker said of his merger attempt, 'it put SGX on the map, it made people sit up and take notice of us and it opened many new doors'.[139] Organic growth and strategic cooperation continued to be possibilities.[140]

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[129] Chris V Nicholson, 'Regulators Set to Reject Merger of Singapore and Australia Exchanges', *The New York Times* (5 April 2011) <http://dealbook.nytimes.com/2011/04/05/australia-says-its-set-to-reject-sgx-asx-merger/?_r=0> accessed 12 September 2013.

[130] Nicholson (n 129).

[131] Chris V Nicholson, 'Australia Rejects Exchange Deal', *The New York Times* (8 April 2011) <http://dealbook.nytimes.com/2011/04/08/australia-rejects-exchange-deal/> accessed 12 September 2013.

[132] 'Exchange Mergers: Back for More', *The Economist* (London, 11 February 2011) <http://www.economist.com/node/18114593> accessed 12 September 2013.

[133] Michael Richardson, 'ASX Deal Could Bring New Foreign Capital Flows' (10 December 2010) *Australian Financial Review* 67.

[134] Robert Laible, 'ASX/SGX merger presents synergies and hurdles', *The Trade News* (27 October 2010) <http://www.thetradenews.com/newsarticle.aspx?id=5184> accessed 23 December 2013.

[135] Bettina Wassener, 'Singapore Exchange to Buy Australia Counterpart', *The New York Times* (25 October 2010) <http://www.nytimes.com/2010/10/26/business/global/26exchange.html> accessed 12 September 2013.

[136] Robert Laible, 'ASX/SGX merger presents synergies and hurdles', *The Trade News* (27 October 2010) <http://www.thetradenews.com/newsarticle.aspx?id=5184> accessed 23 December 2013.

[137] Robert Laible, 'ASX/SGX merger presents synergies and hurdles', *The Trade News* 27 October 2010 <http://www.thetradenews.com/newsarticle.aspx?id=5184> accessed 23 December 2013.

[138] Nicholson (n 131).

[139] R Sivanithy, 'Failed ASX bid put SGX on the map: Bocker', *The Business Times Singapore* (15 March 2012).

[140] Kevin Brown 'SGX chief plays down failed offer', *Financial Times* (19 April 2011) <http://www.ft.com/cms/s/0/10581860-6aa0-11e0-80a1-00144feab49a.html#axzz2eeAmwUYw> accessed 12 September 2013.

Becoming a global stock exchange Historically, SGX has focused on listing companies in the Southeast Asia region. More recently, however, Singapore has begun promoting itself as the 'Asian Gateway'. With Singapore having established itself as a prominent hub for international trade, the city-state is hoping for similar traction in international finance. SGX's ambitions are to establish itself as a global stock exchange.[141] **9.63**

SGX established the 'S-chip' market which targets mainland Chinese companies, especially ones that have been unable to list in Hong Kong due to crowding out by the bigger, state-owned Chinese companies. Generally speaking, SGX regards the S-chip market as successful.[142] However, this success has come at some reputational cost; SGX is known as an exchange for sub-par Chinese companies. In 2010, for example, over 20 companies were on a watch list or were in the process of being delisted because of poor performance. Eight of these companies were from mainland China, of which one was noted for its 'founders [having] fled while owing millions'.[143] **9.64**

SGX is also expanding product range into derivatives and currency.[144] Noting that Singapore is the world's fourth-largest foreign exchange trading hub, Mr Bocker said that the addition of Asian foreign-exchange futures would capitalize on Singapore's foothold in trading in Asian currencies. At the outset, SGX is expected to offer the four currency pairs of AUD/USD, AUD/Yen, INR/USD and USD/SGD and the contracts 'aim to make managing currency risk more efficient by allowing investors to rely on some of the same collateral posted against trades in derivatives ilnked to key Asian stock indexes'.[145] Derivatives may seem like good news for SGX. In the second quarter of 2013, SGX's derivatives business grew 21 per cent to $45.7 million. Average month-end open interest on derivatives also rose 83 per cent to 2.5 million contracts while SGX's OTC clearing service, saw volumes increase by 56 per cent to 88,650 contracts on the back of a 90 per cent increase in iron ore swaps. In addition, SGX enjoyed record high volumes for its China A50 futures and Japan Nikkei 225 options. These contributed to increases of 9.5 per cent in total revenue to $162 million and 16.9 per cent in profit to $76 million for that quarter.[146] **9.65**

Yet, these numbers are markedly lower than those of the pre-global financial crisis era. In 2008, when SGX's derivatives business was 30 per cent smaller, SGX reported profits of $444.3 million thanks in large part to daily securities trading that was 75 per cent higher than it is today. These figures represent a bigger problem in Singaporean capital markets; trading volume is falling. Notwithstanding that the Straits Times Index (STI) has rebounded strongly after the global financial crisis, trading volumes have not recovered and share turnover velocity—a measure of trading volume relative to the size of the market—in the second **9.66**

[141] Jeffrey Friedland, 'Singapore Stock Exchange's "Asian Gateway" policy attracts listings by foreign companies', *Friedland Capital News* (15 March 2011) <http://friedlandcapital.wordpress.com/2011/03/15/singapore-stock-exchange%E2%80%99s-%E2%80%9Casian-gateway%E2%80%9D-policy-attracts-listings-by-foreign-companies/> accessed 12 September 2013.

[142] Friedland (n 141).

[143] Tsui (n 110).

[144] Matthew Walter, Katy Burne, and Jacob Bunge, 'SGX cool on talk of another tilt at ASX', *The Australian* (14 March 2013) <http://www.theaustralian.com.au/business/wall-street-journal/sgx-cool-on-talk-of-another-tilt-at-asx/story-fnay3vxj-1226596741407> accessed 12 September 2013.

[145] Walter, Burne, and Bunge (n 144).

[146] Joan Ng, 'Riding the Bull', *The Edge Singapore* (28 January 2013).

quarter of 2013 was 44 per cent, compared to 72 per cent in 2008.[147] Regardless of the reasons for this, as one market analyst wrote, 'while we continue to view the SGX's solid longer-term growth prospects as a regional hub as strong, led by regional derivatives trading where it is gaining good momentum, we highlight that the nearer-term fortunes of the stock are driven by current securities market volumes'.[148]

9.67 The local market in Singapore is problematic. Unlike Hong Kong, Singaporean investors have appeared relatively uninterested in the equity markets; they like real estate. Singapore practices state capitalism, and government has taken several steps since 2009 to cool down the property sector, increasing stamp duties on property transfers and curtailing the availability of mortgages.Some analysts have seen decreases in residential property transaction volumes by 50 per cent and prices by 7 per cent.[149]

9.68 The SGX has also set out to woo the local retail investor, publishing analysis showing that the STI has outperformed property prices over the past decade, with good prospects ahead. On this front, 'to increase trading volumes as well as velocity, [Mr] Bocker has led a concerted push into developing the retail market by working more closely with the local remisier community and stepping up education initiatives'.[150] In 2012, SGX launched My Gateway, an investment education portal that facilitates Singaporean retail investor access to SGX. Through resources such as explanatory videos and notes, the portal informs retail investors about the merits of investing in the stock market and educates them on topics ranging from the business models and risks of telecoms companies to exchange-traded funds (ETFs). Furthermore, SGX has imposed higher standards for companies seeking to list their securities on the Mainboard, sought regulatory approval to require a larger proportion of initial public offerings of shares for the retail market, introduced dual-currency stocks and ETFs, and even run a share-investing contest that drew more than 13,000 participants online.[151] And the SGX Academy, which runs professional training courses and seminars, is rapidly expanding its outreach.

9.69 Growing its domestic market is one strategy for Singapore, but it has not given up on looking outwards, despite the Australian bruising. In the aftermath of the failed SGX-ASX merger, in mid-2012, SGX and ASX established a new trading link for derivatives. Under the arrangement, each exchange sets up a hub in the other's co-location data centre, allowing customers at one exchange's co-location center trade directly on the other's derivatives segments.[152] ASX is set to connect its Australian Liquidity Centre members directly to SGX's derivatives arm, the only international platform offering Chinese and Indonesian futures.[153]

9.70 SGX has been intimately involved in similar cooperation agreements in the Asean region. Forecasted to grow at 5 per cent in 2013, the region is comprised of ten countries with a

[147] Ng (n 146).
[148] Ng (n 146).
[149] Ng (n 146).
[150] Ng (n 146).
[151] Ng (n 146).
[152] Anish Puaar, 'ASX and SGX forge derivatives trading link', *The Trade News* (1 July 2012) <http://www.thetradenews.com/news/Asset_Classes/Derivatives/ASX_and_SGX_forge_derivatives_trading_link.aspx> accessed 12 September 2013.
[153] Puaar (n 152).

cumulative GDP of $2 trillion, a rapidly growing middle class and a high savings rate.[154] SGX is an integral member of Asean Exchanges, which is a collaboration of seven stock exchanges from Singapore, Malaysia, Vietnam, Indonesia, Philippines, and Thailand aimed at promoting Asean securities as an asset class. In 2012, Asean Exchanges launched Asean Link, a platform that facilitates cheaper and quicker access to equities listed on the connected exchanges by having brokers in different member countries pick up orders from each other via the Link. This is in stark contrast to previously technically complicated and expensive direct connections that brokers in the various countries had to establish with each other.[155] Asean Link is similar to a three-way South American link established in 2011 between Chile, Peru, and Colombia.[156] In order to drum up activity on the Link, shares in Singapore, Thailand, and Malaysia are exempt from capital gains taxes if purchased over the Link.[157]

Despite the hype, a year after the launch of Asean Link, cross-border volumes using the Link remained low. Home bias is keeping Asean investors in their local markets with which they are familiar and where they are not subject to rapid currency fluctuations.[158] The regulatory framework for cross-border trading may also be lagging (advertently or inadvertently), resulting in a regulatory tangle investors are unwilling to negotiate.[159] In a face-saving statement, Asean Exchanges called the Link a 'long-term initiative'.[160] The Link is also targeting the low end of the market, the smaller brokers, since large traders already have existing infrastructure and relationships in place to conduct cross-border equities trading. **9.71**

In continuous pursuit of outreach, SGX has also established hubs in Chicago and London, opened an access point in Frankfurt and tied NYSE Euronext's global trading network into its home market centre.[161] This makes SGX the first Asian-based exchange to have hubs in both Europe and the United States, which SGX promotes as access to the world's largest offshore market for Asian equity futures.[162] Similarly, SGX and Eurex have linked up their data centres.[163] SGX has also entered into a licensing agreement with MSCI, an index provider, to list futures linked to more equity indexes in Asian markets. Also, SGX has entered into an agreement with Korea Exchange (KRX) for over-the-counter derivatives clearing services, enabling clients to transfer positions between their clearinghouses.[164] **9.72**

Singapore is a speck in the Asia Pacific. Despite its vast hinterland, Singapore's challenge is growth; Malaysia and Hong Kong have each established themselves as leaders in niches **9.73**

[154] Jason Ng, 'Slow Start for Southeast Asian Stock-Trade Link', *The Wall Street Journal* (New York, 20 March 2013) <http://online.wsj.com/article/SB10001424127887323419104578372130557048370.html> accessed 12 September 2013.
[155] Ng (n 154).
[156] 'Bursa, SGX in Asean link soon', *New Straits Times* (Malaysia, 4 September 2012).
[157] Ng (n 154).
[158] Ng (n 154).
[159] Ng (n 154).
[160] Ng (n 154).
[161] Tommy Fernandez, 'Singapore Merges Technology, Operations Units', *Securities Technology Monitor* (28 March 2012) <http://www.securitiestechnologymonitor.com/news/Singapore-Reorganizes-Operations-30265-1.html> accessed 23 December 2013.
[162] 'SGX chooses BT for Chicago and London hubs', *FOWeek* (1 June 2012) <http://www.fointelligence.com/Article/3046336/SGX-chooses-BT-for-Chicago-and-London-hubs.html> accessed 23 December 2013.
[163] Kenneth Lim, 'Singapore Exchange, Eurex complete data centre link-up', *The Business Times Singapore* (13 December 2012) <http://www.businesstimes.com.sg/premium/companies/others/singapore-exchange-eurex-complete-data-centre-link-20121213 > accessed 23 December 2013.
[164] Walter, Burne, and Bunge (n 144).

which Singapore might have filled. Although Singapore's focus is resolutely international and its ambitions those of a full-service financial centre, the state of its domestic markets is a concern. Additionally, the rise of domestic markets in its much larger, close[165] neighbours hems Singapore in. Nevertheless, the dynamism and relentless opportunism of the SGX keep Singapore on the map, as does Singapore's own variety of state capitalism. As in Malaysia, in Singapore the government and the markets work unabashedly hand in hand.

3.3 Bahrain and Dubai

9.74 Despite their close proximity in the Persian Gulf and membership in the Gulf Cooperation Council (GCC), Bahrain and Dubai are very different places. Bahrain, a constitutional monarchy, is a small archipelago with its main island[166] tethered to Saudi Arabia via a 20km-long causeway.[167] As an ancient centre of human civilization—7,500 years-old by some estimates[168]—Bahrain was an important fresh water oasis along age-old trading routes. Despite recent desertification, perhaps the millennia of traders help explain Bahrain's reputation for openness towards foreigners and large expatriate population.[169]

9.75 Dubai, meanwhile, is a glittering new city studded with spectacular skyscrapers, only made possible through a potent combination of oil wealth and modern technology. Unlike Singapore, Dubai is not a city-state but is one of two major cities within the United Arab Emirates (UAE). From its oil industry origins, the ambitions of Dubai are to transform itself into a major financial hub for the Middle East and Gulf region by diversifying away from oil and into financial services.

3.3.1 Bahrain

9.76 With little by the way of oil resources in comparison to its neighbors, from early on Bahrain looked to different ways of growing its economy. Offshore banking became its vehicle of choice. In building an offshore banking industry, Bahrain brought in British bankers and British banking; the latter arrived, not by way of formal legislation, but the more practical 'rule books' of the banking business.

9.77 As in other places in the Gulf and the Middle East, the legal system in Bahrain is a complicated mix of systems and influences, formal and informal. Bahrain, like similarly situated jurisdictions, demonstrates a high tolerance for what might be called 'applied legal pluralism'. Civil code influences (as adapted by and emanating from Egypt and Lebanon, for example) operate in the region in a formal way, but tend to be somewhat marginalized. Islamic law is pervasive, manifesting itself in multiple guises, to a greater or lesser extent, depending on the circumstances. The legal framework for finance, on the other hand, often finds its inspiration in the City of London and the English common law for a variety of

[165] Relatively close, this being the vast expanse of the Asia Pacific.

[166] A tiny 55km by 18km.

[167] And it is soon to be tethered to Qatar by another, longer causeway.

[168] The earliest civilization in modern day Bahrain was the Dilmun civilization, which has also been claimed by some to be the location of the biblical Garden of Eden, <http://www.theregister.co.uk/2010/12/09/ancient_dilmun_garden_eden_gulf_lost_civilisation/> accessed 23 December 2013.

[169] In line with its tolerance and openness, Bahrain also hosts expatriate compounds for foreign workers who are employed in a conservative Saudi Arabia but who return home to Bahrain across the causeway for a gin and tonic after work.

political and historical reasons. More recently, with the internationalization of finance, an overlay of international financial standards adds concepts drawn from the US regulatory system to this already heady mix.

For Bahrain, importing British banking was relatively straightforward; they imported the British bankers who knew the rules of the City (and who would bring the rulebooks with them).[170] Being an offshore financial centre though is a competitive business. Growth and diversification are often a part of the adaptive process. In small centres, such as Bahrain, the direction of this growth and diversification is usually a matter of macroeconomic policy (driven by ultimate concerns of basic survival), and not necessarily commercial or market considerations. 9.78

Bahrain as a niche market Bahrain's economy sits as an anomaly among regional economies heavily reliant upon extractive industries. Its finance industry stands out among its regional counterparts as the most mature and developed, providing a conduit to the rest of the world for the region's vast reserve of petrodollars. At the same time, international investors have for long channelled capital into the Gulf region through Bahrain. Most notable, perhaps, is the gateway status that Bahrain has for financial flows to Saudi Arabia, conveniently linked by causeway. Dubai and Doha, though, have begun to encroach on Bahrain's turf,[171] although Bahrain continues to be competitive in terms of a lower cost of living. Incentives always play a role in niche markets; Bahrain offers low tax rates and attractive free-trade agreements.[172] In the 2013 Index of Economic Freedom, Bahrain is ranked first in the MENA (Middle East North Africa) region and twelfth globally.[173] 9.79

Most importantly, Bahrain has a longstanding reputation as one of the most efficient and stable finance industries in the Gulf region.[174] Offshore banking is one thing though; capital markets are another. Bahrain's stock exchange lost out to investors seeking quick gains from the volatility elsewhere in the region, despite the country's reputation for efficient regulation and a long-term base of investors.[175] With two new exchanges, Bahrain is over exchanged. 9.80

[170] The capital (and other markets) are still governed by 'rulebooks'. Decree No 64 of 2006 implemented the Central Bank of Bahrain and Financial Institutions Law (CBB Law 2006) and is the umbrella legislation for the country's financial markets. CBB Law 2006 established the Central Bank of Bahrain (CBB) to replace the BMA as the country's monetary authority and financial markets regulator, which includes oversight of banking, insurance, investment business licensees, and other financial services providers. The CBB also regulates Bahrain's licensed exchanges and clearing houses. The CBB Law also included the development of a new set of capital markets regulations. In addition, laws and regulations were compiled into a Rulebook, in which distinct volumes cover different areas, such as conventional banking, capital markets, collective investment undertakings, and Islamic banking. The regulatory framework for capital markets is comprised of the CBB Law 2006, Volume 6 of the CBB Rulebook and CBB Capital Markets Regulations (collectively, 'Capital Markets Regime'). See OECD, *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Bahrain in 2011: Phase 1: Legal and Regulatory Framework* (OECD Publishing, August 2011), 12.

[171] Simeon Kerr, 'Bahrain: Hopes pinned on niche role', *Financial Times* (12 October 2012).

[172] Rob Denman, 'Bahrain? Bank on it', *Site Selection—The Middle East*, June 2013. In Bahrain, incentives are not restricted to 'zones', but available throughout the country. They include 100% foreign ownership of 95% of business activities, the freedom to repatriate capital, profits, and dividends, and, very attractively, 0% personal and corporate income tax.

[173] Bertelsmann Transformation Index, Bahrain Country Report, 'Organization of the Market and Competition' (2012) <http://www.bti-project.org/laendergutachten/mena/bhr/2012/#economic> accessed 23 December 2013.

[174] Kerr (n 171).

[175] Oxford Business Group, The Report: Bahrain 2008, 'Finding a niche market—building from an established base', 69.

Regulatory reputation matters, though and the Central Bank of Bahrain (CBB), through its capital markets arm, the Capital Markets Supervision Directorate (CMSD), is seen as the most efficient regulator in the Gulf region. It is a consolidated regulator (in the UK FSA style) and noted for robust policymaking.[176] Stability is also supported by a currency pegged to the US dollar.[177]

9.81 Contributing close to 25 per cent of Bahrain's GDP, the finance sector is larger than the energy sector.[178] Bahain hosts a large expatriate community, but Bahrainis represent over 70 per cent of employment in the finance industry,[179] although only 25 per cent of the overall labour force. State 'nurturing' is extensive, prompting rapid growth in the finance industry in recent years; total assets in the industry were close to 22 times larger than the country's GDP.[180] However, the main Bahrain exchange, the BHB, is one of the smallest and least liquid in the region, with an average turnover of less than 4 per cent of overall capitalization. Lack of liquidity is often fatal to an exchange, yet in this case, long term institutional investors like pension funds which do not profit from volatility are cited as the support for this market. Stability, it is said, has sustained the BHB internationally. In 2006, while other regional markets showed sharp losses, Bahrain's primary stock exchange continued to make small gains. Additionally, the BHB's relatively lower levels of trading and volatility also provide for relatively attractive price-to-earnings (P/E) ratios: the average P/E ratio by early 2008 was 15.1, compared with 21.9 for Tadawul in Saudi Arabia and 21.7 for Dubai Financial Market.[181]

9.82 Bahrain has also encouraged the development of a regional hub for mutual funds; in 2007 the CBB refreshed its categories for registration of mutual funds, each with its own set of regulatory requirements, insulating smaller investors from the risks larger institutional investors could take on. By early 2008, there were almost 2,500 mutual funds registered in Bahrain, most foreign-managed,[182] with a net asset value of close to $16 billion, representing an increase of 73 per cent in the preceding 18 months.[183]

9.83 Situated as it is, Bahrain naturally looks to Islamic finance and the market in sukuk, the primary Islamic financial instrument. In 2001, the CBB pioneered its issuance of sukuk and later that same year, began to develop a Liquidity Management Centre (LMC) to purchase and restructure sukuk into short-term debt. Today, CBB is one of the largest lead managers for sukuk and sukuk capitalization in 2009 exceeded $100 billion, having seen a sharp increase after 2007. Sukuk now dominate the Bahrain debt market with over a 90 per cent

[176] 'Bahrain: Financial Services Report', *The Economist* (22 June 2010).
[177] Oxford Business Group, The Report: Bahrain 2008 (n 175), 69.
[178] 'Bahrain: Financial Services Report' (n 176).
[179] Oxford Business Group, The Report: Bahrain 2008, 'First to market—Bahrain's diversified financial sector serves as a centre for the region', 49.
[180] Oxford Business Group, The Report: Bahrain 2008 (n 179), 49.
[181] Oxford Business Group, The Report: Bahrain 2008 (n 175), 71.
[182] Volume 6 of the Rulebook on Capital Markets was aligned with EU Directives regarding retail funds. In 2012, the economic crisis coupled with the growing popularity of mutual funds in Bahrain prompted the country to introduce a revised framework for collective investment schemes. See Oxford Business Group, The Report: Bahrain 2008 (n 179), 50; Oxford Business Group, The Report: Bahrain 2009, 'Tailor-made: highly regulated business environment with numerous incentives', 207.
[183] Oxford Business Group, The Report: Bahrain 2008 (n 175), 72.

share.[184] In 2010, the CBB issued its third international sukuk, valued at $1.25 billion, listed on the London Stock Exchange.[185]

Islamic finance is notoriously resistant to standardization, one of its primary drawbacks as a commercial matter. In promoting its position as an Islamic finance centre, Bahrain has made itself home to several institutions designed to instill greater standardization into Islamic financial products. The AAOIFI, with some 200 members, sets the accounting, auditing, governance, ethics, and Sharia interpretation standards for Islamic finance institutions. Bahrain was the first country to make compliance with AAOIFI mandatory and other Gulf states followed suit. Bahrain also plays host to the IIFM, which sets international standards for Islamic capital and money markets and the Islamic International Rating Agency (IIRA), which, among other things, carries out Sharia compliance assessments. Finally, the LMC continues to inject liquidity into the sukuk market. **9.84**

In 2011, a new exchange opened in Bahrain, BFX, part of a chain of nine exchanges owned by Financial Technologies India; the Bahraini government initially participated in setting up BFX. The products traded, overlap with those of the BHB, stocks, sukuk, and other Islamic securities, although diversified into derivatives and commodities, the idea being to create a 'multi-asset' exchange in the region.[186] Within the BFX sits an Islamic finance division known as Bait Al Bursa, which exclusively offers electronic exchange-traded Islamic financial instruments, offering a diversified portfolio and a single venue for all exchange-traded business in the Islamic finance sector.[187] At least, that was the plan. BFX had a troubled start, experiencing serious delays, drastic downsizing and a generalized lack of interest. BFX may represent something else entirely though; the exchange as commodity. Given the tie up of NYSE and Qatar as well as Dubai and NASDAQ, BFX may have been established to be sold to a larger, international group. Certainly in the region, the trend is towards exchange consolidation. **9.85**

It may seem anomalous that such a small place as Bahrain could support not one, not two, but three exchanges. In another effort to capture specialized international trading, in January 2013 Bahrain became home to the Joint Arab Bourse (JAB), expected to begin operations in 2014.[188] JAB will be the first common Arab stock market and a private sector oriented initiative, with a market estimated at $3 trillion. As with exchanges elsewhere, JAB is reaching into the lower tiers for business, targeting small and medium-sized enterprises. JAB is as much a political statement as a trading venue,[189] and its establishment in Bahrain is consistent with Bahrain's efforts to foster the institutions supporting Islamic finance as well as traditional market activity which appears difficult to generate. **9.86**

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[184] Sat Pal Parashar, 'Sukuk Industry Development in the Bahrain Capital Market' in Mohamed Ariff, Munawar Iqbal, and Shamsher Mohamad (eds), *The Islamic Debt Market for Sukuk Securities: The Theory and Practice of Profit Sharing Investment* (Edward Elgar Publishing, 2012), 157.

[185] Pakashar (n 184).

[186] Oxford Business Group, The Report: Bahrain 2012, 'An expanding market: new regulations and the introduction of a second Bourse have boosted the kingdom's appeal'.

[187] Abdul Rahman Al Baker, 'Creating strong foundations for the next phase of development of Islamic Investment Markets 2010', 6th Annual World Islamic Funds and Capital Markets Conference Opening Remarks (Bahrain: Manama, 24 May 2010).

[188] Maryam Aziz, 'Forum announces Arab Bourse project', *Nuqudy News* (14 January 2013).

[189] See Aziz (n 188): The Joint Arab Bourse will offer 'a safe haven for domestic and regional capital,' attract foreign and migratory capital and harness 'modern technology to facilitate the flow in investment… bringing Arab investment opportunities to [the] attention of the world's major financial centres'.

9.87 On the formal regulatory side, capital markets activity in Bahrain is overseen by the Capital Markets Supervision Directorate (CMSD) within the CBB. The CMSD acts as the listing authority for companies and financial instruments on the country's exchanges. The transition phase to new regulations for capital markets is still in process; the 'Rulebook' is still incomplete and only applies to the extent that the relevant sections are available. For example, at present, the Capital Markets Volume of the Rulebook does not include a segment on Offering Securities, Listing Requirements, and Disclosure Requirements, possibly representing a lack of demand. As such, these areas of the prior capital markets regulations are still applicable, pending completion of the CBB Rulebook.

9.88 Reputation is important to Bahrain, so it pays close attention to compliance with international standards as a signalling mechanism to the international marketplace. In 2005–06, a Financial Sector Assessment (FSAP) was conducted in Bahrain by the IMF and its capital markets regulation and supervision assessed against the IOSCO Objectives and Principles of Securities Regulation.[190] The resulting report acknowledged Bahrain's generally high standard for capital markets regulation and supervision, noting that the country was in compliance with most of IOSCO's core principles.[191] This assessment was carried out at a pivotal time: numerous regulatory reforms were underway, the CBB Law 2006 was introduced and the CBB was being established as the successor to the Bahrain Monetary Authority. Two years later, Bahrain became the first national market regulator in the GCC to be accepted as an IOSCO member.

9.89 As one CBB official put it, 'it is not a question of whether we are the financial centre in the Gulf, it is a question of whether we will continue to be the centre. We have to be vigilant'.[192] So, Bahrain continues to diversify its finance sector, partly in response to competitive threats from nearby Dubai and Qatar. It benefits from having a sizeable and experienced finance sector labour force and an adaptable regulatory attitude towards changing market conditions. What began three decades ago as an effort to diversify the Bahraini economy away from its reliance upon the energy sector has created a modest, but so far effective, niche market.

3.3.2 Dubai

9.90 Dubai has pursued a different strategy from Bahrain for its financial markets. Dubai's ambitions have gone beyond creating a regional niche market; for Dubai it has been the big gesture, cutting a dashing figure on the world stage.[193] Coming later to the world of international finance, Dubai has mirrored some of Bahrain's attractions,[194] but from there Dubai has gone its own way, embarking on a novel and ambitious experiment.[195] It is not obvious the experiment will succeed.

[190] International Monetary Fund, *Financial System Stability Assessment: Kingdom of Bahrain* (12 January 2006).

[191] IOSCO in 2010 introduced eight new IOSCO principles which the CBB indicated it would integrate into its Rulebook.

[192] Oxford Business Group, The Report: Bahrain 2008 (n 179), 50.

[193] Dubai's monumental ambitions are made possible by the very deep pockets of its government.

[194] Permitting 100% foreign ownership, no taxes on profits or income, a range of double taxation treaties to the extent any tax liability is triggered and a showy adherence to international standards.

[195] See, generally, Jawad I Ali, 'Dubai International Financial Centre—entrance to the global economy' (King & Spalding LLP, 20 January 2012).

Unlike Bahrain, Dubai did not just import British bankers, with their rulebooks tucked in their valises. In 2004, Dubai set about dropping a new, improved, City of London into the desert, the Dubai International Financial Centre (DIFC). Like the City of London, the DIFC is a small, geographically defined area, 110 acres, within the heart of Dubai City. It is recognized as a distinct and independent jurisdiction within Dubai, which is itself one of seven emirates, or principalities, which form the UAE. As a federal financial free zone, the DIFC has the legislative power to create its own laws, regulations and institutions for all of private (civil) and commercial law.[196] From the outset, the strategy behind the DIFC was to create an international financial centre of world stature, connecting business and financial institutions in both emerging and established markets throughout the world.[197] The US dollar, the undisputed reserve currency of the world at the time, was adopted as the operating currency in the DIFC. **9.91**

As a legal and regulatory experiment, the DIFC is an interesting case, one that has caught the imagination of many. Like Bahrain, the UAE (of which Dubai is a part) demonstrates a complex, hybrid, legal system, a mixture of civil, common and Islamic law. Despite the UAE now characterizing itself as a predominately civil law jurisdiction, the common law was traditionally present due to the UAE's informal colonial ties with Britain. However, after UAE independence, the common law was rejected in favour of civil law codes. Unsurprisingly, Islamic law—Sharia—also operates within the UAE, enjoying constitutional support. In practice, however, Sharia is treated as a subsidiary source of law, to be applied when civil law codal provisions and other available sources fail in specificity.[198] **9.92**

At its creation in 2004, however, the DIFC adopted the common law, even going so far as to import a common law judiciary. So along with the British bankers, in came British judges[199] and a UK-style regulator. But it is not quite so simple (and the common law itself is never simple). For example, the capital markets in the DIFC are governed by the Markets Law 2012 (DIFC Law No 1 of 2012)[200] and the Markets Rules (MKT), which are collectively **9.93**

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[196] However, federal criminal laws apply within the DIFC.

[197] Ali (n 195). The Dubai version of the creation of the DIFC somewhat ignores the role of Bahrain. Prior to the inception of the DIFC, the GCC lacked a regulated financial centre with internationally known and accepted standards. Therefore, Federal Decree No 35 of 2004 established the DIFC to correct the regional inadequacies and created a financial free zone in Dubai, though one distinguished from other such zones in the UAE. The overall framework of the DIFC was designed to attract and ensure continued connectivity with global banks and financial institutions. It was designed to centralize regional wealth in an environment designed for wholesale banking, capital markets, asset management, reinsurance, Islamic finance, and companies whose services are ancillary to these sectors.

[198] Nasser Saidi, 'The Success of the DIFC as an International Financial Centre', Working Paper (2009), <http://nassersaidi.com/2009/09/01/the-successes-of-difc-as-an-international-financial-centre-sept-2009/> accessed 16 January 2014.

[199] The DIFC Courts were established by Dubai Law No 12 of 2004. They are an independent, English-language common law judiciary within the autonomous DIFC exercising jursidiction over national and international civil and commercial law. Unless parties have selected otherwise, the Courts' substantive law is developed by the DIFCA and DFSA, with its procedure imported from the rules of the Commercial Court in London. They work alongside and in cooperation with the Dubai courts, where the language is Arabic and procedure stems from the continental civil tradition. The DIFC Courts' independence from executive policy in Dubai is one of the factors lending credence to its aspirations as a sound financial centre. See Anthony Evans, 'The facts about the DIFC Courts', *Financial Times* (11 November 2011) and Ludmila Yamolova, 'DIFC Courts: Redefining the judicial process' (HPL Yamalova and Plewka Legal Consultancy, February 2010) <http://www.lyhplaw.com/publications/02-10%20Ludmila%27s%20Article%20re%20DIFC%20Court.pdf> accessed 16 January 2014.

[200] Note the civil law formulation of the legislation.

referred to as the 'Markets Regime 2012'. However, Islamic finance also operates within the DIFC and must be supported by Islamic law. So there is also the Law Regulating Islamic Finance Business 2004 (DIFC Law No 13 of 2004) and the Islamic Finance Rules (IFR), known collectively as the Islamic Markets Regime.[201]

9.94 Not surprisingly, the regulator created for the DIFC in 2004 emulated the United Kingdom's FSA, then the leading model.[202] The DFSA is a unitary regulator within the DIFC and has complete jurisdiction over all the participants in the capital markets, banking and credit services, asset management, securities, collective investment funds, custody, trusts and services, commodities future trading, Islamic finance, insurance, and exchanges. Moreover, the DFSA authorizes, licenses, and registers markets participants operating within the DIFC. Again along FSA lines, the now somewhat tarnished risk-based regulatory approach was formally adopted.[203] A Financial Sector Assessment (FSAP) conducted by the IMF and The World Bank in 2007 against the IOSCO Objectives and Principles of Securities Regulation found the DFSA to have 'fully implemented' 27 out of the 29 principles assessed. The remaining two principles, dealing with collective investment schemes, were 'broadly implemented'.[204]

9.95 The FSAP results merit closer scrutiny. As a point of comparison, the FSAP conducted in the United States and published in May 2010 found the SEC/CFTC to have fully implemented only 16 out of 29 IOSCO principles, albeit being held to a higher standard. But the DIFC ratings must bring into question the utility of the FSAP exercises, when a capital market as dysfunctional as Dubai's rates so highly. The ratings demonstrate a phenonemon present in other developing economies, chasing the ratings. Developing economies comply blindly in creating regulatory structures which will 'check the boxes' in international standards, while failing to make real progress towards viable capital markets. The DFSA's continuous effort to meet global standards led to the new Markets Regime 2012,[205] which followed a new international model, the EU Prospectus Directive, as well as picking up more UK refinements such as the revised Corporate Governance Code.[206]

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[201] The Islamic Markets Regime attaches special rules for Institutions Conducting Islamic Financial Business (ICIFB). Such an institution is defined as those 'carrying on,' or holds itself out as carrying on, a financial service in or from the DIFC as 'in accordance with Shari'a'. See the Law Regulating Islamic Finance Business 2004 (DIFC Law No 13 of 2004) s 10. There are two types of institutions that fall within this ambit: Islamic Financial Institutions (IFI) and Conventional Financial Institutions (CFI) whereby parts of their dealings are with Islamic securities, the so-called 'Islamic window' also found elsewhere in the world. It is worth noting that the regulator in the DIFC, the Dubai Financial Services Authority (DFSA), does not hold itself out as a Sharia regulator, but rather a Sharia systems regulator. Sharia compliance is not its concern; rather it requires ICIFB to implement a system of governance that oversees Sharia compliance.

[202] Dubai Law No 9 of 2004 established the DFSA as the single supervisory and regulatory authority of the DIFC. DIFC Law No 12 of 2004 (Regulatory Law) provides for the constitution of the DFSA and vests it with the necessary rule-making authority. The main responsibilities of the DFSA centre around administering the core financial services related laws, which include six laws created over the past decade that are aimed at regulating markets, trusts, investments, and Islamic financial business: Oxford Business Group, Bahrain Report 2008 (n 177).

[203] Saidi (n 198).

[204] IMF/World Bank, 'Dubai International Financial Centre: IOSCO Objectives and Principles of Securities Regulation' (FSAP, IMF Country Report No 07/365, Washington DC, November 2007).

[205] The Markets Regime 2012 repealed and replaced Markets Law 2004 the Offered Securities Rule (OSR) (Markets Regime 2004). The DFSA proposed the changes in 2011 in order to align itself with leading jurisdictions, while accommodating the capital markets of the GCC region. DFSA, 'Proposed Changes to the Market Law Regime Part 1', Consultation Paper No 75 (11 April 2011).

[206] DFSA, 'Proposed Changes to the Market Law Regime Part 2—Recognition and Auditing', Consultation Paper No 76 (15 June 2011).

The DIFC is not the only financial market in Dubai, and neither is the DFSA the only regulator. Outside the geographic confines of the DIFC exists a parallel system. The Government of Dubai incorporated the Dubai Financial Market in 2000, operating as one of two local stock exchanges within the UAE, the second one being the Abu Dhabi Securities Exchange (ADX). The Emirates Securities and Commodities Authority (ESCA) is the regulator for the DFM. Again, in keeping up with international fashion, the DFM became a public joint stock company in 2006, through an initial public offering of 20 per cent of its shares, the remaining 80 per cent being sold to Borse Dubai (BD) a government-owned holding company.[207] **9.96**

Nasdaq, OMX, and Borse Dubai In 2007 the NASDAQ, the US stock market operator and Borse Dubai, the government-owned holding company, put an end to a protracted battle over their bids for OMX, the Nordic exchange group, by deciding to work together in a deal that has had wide-reaching implications for international capital markets. The complex agreement involved Borse Dubai advancing its $4 billion cash bid for OMX, only to have those shares acquired by NASDAQ in a cash-and-shares transaction that left Borse Dubai with approximately 20 per cent of NASDAQ (but with voting rights restricted to 5 per cent). Meanwhile, Borse Dubai acquired NADAQ's 27 per cent stake in the London Stock Exchange for $1.6 billion. In addition, NASDAQ became the key shareholder in the original DIFX, which became rebranded as NASDAQ Dubai under a licencing agreement.[208] **9.97**

Having fought over OMX for quite some time, NASDAQ and Borse Dubai realized that their interests were compatible. NASDAQ was reportedly interested in using OMX to expand into Scandanavia while Dubai was keen on using the technology it would acquire to further its interests in emerging markets. The arrangement provided NASDAQ with an entry into the Middle East. As for Dubai, though it had successfully developed into a Middle Eastern financial hub, the DIFX had found it difficult to attract listings and a tie-up with NASDAQ in the United States offered increased possibilities.[209] Other Gulf states—including Qatar and Saudi Arabia—had also sought financial hub status; the NASDAQ connection was perceived to be valuable in this regard. The NASDAQ-OMX-Borse Dubai arrangement sat against a backdrop of the Dubai government's decision to combine DIFX and its more successful domestic counterpart, the Dubai Financial Market (DFM), under Borse Dubai. This was intended to offer investors a single platform across which to trade a diverse set of asset classes.[210] The arrangement that led to the newly branded NASDAQ Dubai was hoped to further this effort to compete by consolidating trading technology and providing a platform to further diversification of asset classes.[211] **9.98**

Nasdaq Dubai today The 2008–09 global financial crisis added to Dubai's teething problems, leading to a protracted period of depressed values and generally poor exchange performance. Then, in 2009, Dubai faced an unprecedented crisis when Dubai World, a state-owned enterprise, decided it would not make repayments to its creditors of $26 billion of debt. Having opened up its housing market to foreign ownership in 2002, Dubai saw 20 **9.99**

[207] Oxford Business Group, The Report: Dubai 2007, 76
[208] Stanley Reed, 'Nasdaq, Dubai, OMX in Global Tieup', *Bloomberg Businessweek* (20 September 2007).
[209] Reed (n 208).
[210] Babu Das Augustine, 'Nasdaq DIFX will play key role in Mideast', *Gulf News* (21 November 2007).
[211] Augustine (n 210).

to 30 per cent annual growth in some areas between 2006–08. The bubble finally burst in 2009.[212] In 2011, Dubai's stock indices dropped due to poor performance in the construction and real estate sectors, as well as uncertainty stemming from the banking sector and the so-called Arab Spring, not to mention the Eurozone debt crisis which was in full swing at the time.[213]

9.100 Today, the prospects for Dubai's status as a financial hub are less clear than ever, and champions on both sides have ample evidence to cite. NASDAQ Dubai has only seven listed companies and 12 Islamic bonds. In 2012 and in the first half of 2013 there was a dramatic turnaround in Dubai's stock markets, making them some of the best performers in the world.[214] Also, after failing to secure emerging-market status from Morgan Stanley Capital International (MSCI) for four consecutive years, the UAE finally achieved this status in May 2013. This is expected to attract portfolio investments from an increasing number of global asset managers.[215]

9.101 Earlier in 2013, a few relatively small companies launched their plans for initial public offerings on NASDAQ Dubai. These are the first initial public offerings on the exchange since 2008, suggesting that the effects of the global financial crisis and Dubai's 2009 real estate crisis may be fading. Certainly, real estate prices have recovered strongly and Dubai's main stock index has risen 74 per cent in one year. Although it is still 55 per cent below its peak in 2008, Dubai looks ready to absorb new supplies of equity.[216] Yet both of Dubai's stock exchanges—the DFM and NASDAQ Dubai—need much more liquidity and this will not be easily addressed by small initial public offerings and trading will be low given their size. Much larger listings, perhaps including those of Dubai's large state-backed companies, are necessary if Dubai's capital markets are to get any real boost.[217] At present, a handful of large stocks comprise the majority of trading. Meanwhile, the DFM is represented largely by financial institutions which comprise more than two-thirds of the market and though it has enjoyed healthy liquidity levels over the past year, volatility and uncertainty remain.[218] This is partly because Dubai's success is very much dependent upon only two sectors—finance and property—and such concentration of risk discourages financial flows.

9.102 The largest recent listing to be announced is that of The Bank of London and The Middle East (BLME), the UK's largest Islamic bank, which has indicated that it will list $503 million worth of shares on NASDAQ Dubai in its hopes of encouraging Dubai's prospects as a centre for Islamic finance. It is estimated that Dubai's Islamic finance sector will have assets of up to $2 trillion by 2015.[219] Whether or not Dubai is able to attract more such listings—and larger ones—will determine its viability as an international financial hub. Dubai hosts a unique infrastructure in the form of the DIFC's internationally recognized legal and regulatory framework, a business environment which includes a wide variety of financial

212 Lindo Xulu, 'Dubai Financial Market: a fresh look east', *Financial Mail* (1 March 2013).
213 Economist Intelligence Unit, 'UAE: Financial Services Report' (26 July 2013).
214 Economist Intelligence Unit (n 213).
215 Economist Intelligence Unit (n 213).
216 'Dubai IPOs signal recovery but market wants bigger listings', *Asharq Al-Awsat* (3 October 2013).
217 'Dubai IPOs signal recovery but market wants bigger listings' (n 216).
218 Xulu (n 212).
219 Simeon Kerr, 'UK Islamic bank plans Dubai's first IPO in five years', *Financial Times* (16 September 2013).

services companies, and world-class infrastructure.[220] The question is whether, if you build it, will they come?

The DIFC is less than ten years old, but its history has been marked by constant change and repositioning in terms of finding its footing. Its international exchange, NASDAQ Dubai (the former DIFX), has gone through numerous restructurings and is largely considered a failure. With its deliberate exposure to international capital markets, the DIFC was also buffeted by the global financial crisis, bubbles and near collapses, all perhaps constituting a rite of passage along the way to its status as player in the international financial world. Yet the Dubai government definitely appears to be in the stock exchange business, with its majority state owned enterprise, Borse Dubai, holding 79.63 per cent stake in DFM, 33.3 per cent of NASDAQ Dubai, 20.64 per cent of the London Stock Exchange Group, and 16 per cent in the NASDAQ OMX Group itself.[221] Like a trophy wife, NASDAQ Dubai may be for show, with the real business taking place elsewhere. **9.103**

4. Conclusion

It is a hard business being a niche market, operating in a competitive and often unforgiving environment, engaging in constant repositioning and facing inherent limitations on growth. Surprisingly, perhaps, there are lots of niche markets and a very diverse grouping they are, deploying a variety of survival strategies. In all cases, state capitalism, in various guises, supports these markets. In earlier times, reputation, a friendly regulator, and good business practices might have sufficed. Now, there is a new dynamic. The rise of large, new, Asian markets bent on establishing themselves in their own right, is eroding opportunities in the hinterland for jurisdictions like Singapore. Flash may be dethroning quiet discretion in establishing reputation; in theory, Dubai has one of the very best capital markets regulatory frameworks anywhere, as measured against international standards, and trumpets this fact to the world. As elsewhere, but more so in niche markets, technology is the gamechanger; small as well as large markets can be at the cutting edge. Technology is also providing the means for the creation of large interconnected networks of markets, which may continue to appear distinct on the surface, but which are deeply intertwined through integration of trading platforms as well as formal and informal alliances. **9.104**

[220] 'What does the future hold for Dubai's global hub status?', *Albawaba Business* (18 September 2013).
[221] Oxford Business Group, The Report: Dubai 2013, 70.