



Markets Brief

Wash Trades – sale or purchase of Shares with no change in beneficial ownership

Issue No. 17– February 2018

Introduction

In this edition, we discuss the DFSA's policy regarding 'wash trades'. These are trades involving the sale or purchase of Shares where such trading results in no change in the beneficial ownership of those Shares. The DFSA's Market Abuse Rules cover all Investments, but here we are focused on Shares.

This brief addresses the mechanism by which such transfers should be made and provides examples of situations which might arise.

We also take this opportunity to remind market users about the need to avoid creating or contributing to a false or misleading impression in the market as to the supply of, demand for or price of Investments as a result of entering into transactions for the sale or purchase of Shares where there is no change in beneficial ownership.

Guidance

Please note that the contents of this communication are not intended to be Guidance as contemplated by the Regulatory Law 2004 and the contents should neither be interpreted, nor relied upon, as Guidance. You should refer to the DFSA Rules for Guidance or contact the DFSA if you require individual guidance.

Technical explanations given in this brief are for illustrative purposes only and should not be considered or relied upon as a legal advice. We recommend that independent legal advice is obtained if you are unsure about any aspect of the DFSA markets regime which may apply to you. Defined terms are identified in this brief by the capitalisation of the initial letter of a word or each word in a phrase and are defined in the Glossary Module of the DFSA Rulebook.

Beneficial Ownership of Shares

Beneficial ownership of Shares is distinct from legal ownership or legal title. The beneficial owner is the natural person (sometimes referred to as the ultimate beneficial owner or "UBO") who enjoys the benefits of ownership, such as dividend payments. It also means any natural person who, either directly or indirectly, has the power to vote or influence the investment decisions regarding a specific Share, e.g. voting rights attached to Shares.

It may be the case that the legal and beneficial owners of Shares are one and the same, i.e. the name of the account in which the Shares are held reflects the beneficial as well as the legal ownership. In other cases though, for safekeeping, convenience, or ease of transaction reasons a bank, broker or custodian may hold the legal title to Shares beneficially owned by someone else.

For the purposes of the DFSA's Market Abuse Regime, being clear about the identity of the beneficial owner is relevant to ensuring that a false or misleading impression regarding transactions in the Shares is not created and no misleading disclosures regarding the beneficial ownership of Shares, and consequently the attached voting rights, are made.

Recently a number of issues have arisen regarding the buying and selling of Shares on Nasdaq Dubai, a DFSA Authorised Market Institution, where no change in the beneficial ownership of the Shares took place. Such incidences have given the DFSA cause for concern about compliance with the Markets Law 2012 (the "Markets Law") by market participants as regards the prohibition of Market Abuse and the use of wash trades.

To help address these concerns, the DFSA has taken the opportunity to raise awareness through this Markets Brief of the process by which the legal title of Shares may be transferred without carrying out wash trades and to highlight the need to ensure that any impression created as to the supply and demand of Shares on the market by trading is accurate, true and not misleading. The DFSA also takes this opportunity to stress its view that entering into wash trades is an example of conduct that may constitute Market Abuse.

Market Abuse Provisions

Chapter 1 of Part 6 of the Markets Law sets out conduct which is prohibited on the basis that it constitutes Market Abuse. This includes:

- Engaging or participating in any act, practice or course of conduct relating to Investments that the person knows or reasonably ought to know results in or contributes to, or may result in or contribute to, a false or misleading impression as to the supply of, demand for, or price of one or more Investments – Article 54(a) Markets Law.

The DFSA's Code of Market Conduct ("CMC") provides Guidance on the Market Abuse provisions in Part 6 of the Markets Law. Chapter 2-2 2.(a) of the CMC sets out examples of conduct that, in the DFSA's view, may contravene Article 54(a) by resulting in or contributing to a false or misleading

impression. These include:

- Wash trades – that is, a sale or purchase of an Investment where there is no change in beneficial interest or market risk, or where the transfer of beneficial interest or market risk is only between parties acting in collusion, resulting in a false appearance of trading activity.

Wash trades can create a false or misleading impression in a number of ways.

- They suggest to the market that the supply of Shares includes an offer to sell, where in fact there is no intention for those Shares to be available for purchase by market participants.
- They suggest that the volume of Shares being traded is greater than the true volume of trading amongst legitimate arm's length market participants.
- They distort the genuine level of supply and demand amongst market participants.

In determining whether wash trading constitutes Market Abuse, the DFSA will take into account a number of general factors including:

- the experience and knowledge of the users of the market in question;
- the identity and position of the person responsible for the conduct which has been observed;
- whether the order to trade or transaction does not appear to have a legitimate economic rationale; and
- whether the person has another, illegitimate, reason for undertaking the transaction, bid or order to trade.

(see CMC Section 2-2, paras 5 and 6)

Examples of On-market Transactions Causing Concern to the DFSA

Transactions in the following examples may create a false or misleading impression in the market:

- A person holding Shares in a trading account at one broker uses the market to move those Shares to an account they hold at another broker.
- A person owning Shares through one corporate entity, of which he is the beneficial owner, wishes to transfer those Shares to a different corporate entity of which he is also the beneficial owner.
- A person holding Shares with one custodian wishes to transfer those Shares to another custodian, or into an individual custody account (commonly referred to as a National Investor Number 'NIN') held directly by the Central Securities Depository (CSD)).
- A person who is the beneficial owner of Shares wishes to use those Shares as collateral or security for other finance arrangements, which requires those Shares to be transferred to the entity offering the finance.

In these instances, a false or misleading impression may be created in the market and if so, Persons carrying out orders or transactions in the instances outlined above may be at risk of committing Market Abuse.

How to Transfer Shares where the Beneficial Ownership Does Not Change

In cases where there is a wish to transfer Shares without there being any change to the beneficial ownership, the appropriate process by which the transfer should be carried out is to use the Authorised Market Institution's off-market transfer arrangements and, if appropriate, to use the arrangements for making a pledge of the Shares through the Authorised Market Institution.

Where market participants are unsure about these processes, they should contact the Authorised Market Institution for assistance and guidance.

Further information

The DFSA Markets team can be reached on

markets@dfsa.ae or 04 362 1559. The DFSA will not advise a particular course of action or provide (legal) advice, but it is prudent to keep the DFSA informed of ongoing developments in relation to the Reporting Entity.

Arabic edition

Every Markets Brief is produced in both English and Arabic and is available on the DFSA website.

Contact us

Visit the DFSA website www.dfsa.ae for:

- other editions of the Markets Brief;
- access to DFSA-administered legislation and the DFSA Rulebook, including a full text of the Markets Law and Markets Rules; and
- the Code of Market Conduct (in the Sourcebook Modules part of the DFSA website).

For enquiries:

Telephone +971 4 362 1500

- Email markets@dfsa.ae

Feedback

We appreciate your feedback and welcome any suggestions that you may have. Please email us at markets@dfsa.ae