

# **INSIDER TRADING**

by Dr Barry Rider

**Commentator: Mr Carl Peterson**

Director, Paine Belcher Limited

*standing in for*

**Mr David Belcher**

Executive Chairman, Paine Belcher Limited



While I am not David Belcher I am perfectly comfortable with this address and have worked with David on the content.

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Given the breadth of the specific issues raised in the lengthy paper presented by Dr Rider, I wish to confine my remarks to the fundamentals which I believe need to be addressed in framing any laws or rules which are to operate in the New Zealand commercial environment.

It must be remembered that New Zealand is not Great Britain, the United States or even Australia. To put this in perspective, Australia and New Zealand stockmarkets represent only 2% of the total world markets. In commercial terms we are still very much a small town and therefore to introduce here the level of regulation which may be required in some larger markets would, in the New Zealand context, be equivalent to driving in a tack with a sledgehammer.

In Dr Rider's paper, one particularly salient comment appears in the last paragraph of his conclusion where he states that 'No jurisdiction has succeeded in significantly combatting this form of market abuse and perhaps given the nature of markets and men, none will'.

I believe that insider trading as defined by Dr Rider is not significantly widespread in New Zealand, and the question perhaps needs to be asked whether it is not more a hobby horse of business writers and television commentators than a commercial reality.

But it is fair to assume that in New Zealand, as in other markets, insider trading does occur. The question becomes, what effect does this have?

The sharemarket has always been accepted as a place of risk investment. The public is aware of these risks and participates in the market on a best information basis. As part of this I do not believe that investors expect to insure themselves totally against decisions or actions over which they themselves have no control.

I do not subscribe to the theory that in a country our size, either New Zealand or overseas investors lose confidence in our sharemarket as a result of any perceived insider trading. Given my small town business argument, I do not believe that detection of serious insider trading is very difficult.

I do not believe that corporates need to be overly protected from insider trading, in one anothers' shares, nor do I subscribe to the arguments of lost opportunity nor that insider trading is prevalent enough to provide any form of market price averaging.

I readily accept that the practice of insider trading is undesirable, but what steps should we take to combat it?

I was taken with the phrase used by Dr Rider, 'hinder and impede', and I am comfortable with this as the initial approach to our attacking insider trading, particularly in the areas of education and self-regulatory constraints.

Firstly, I believe in education through increased awareness as being of prime importance for both the professional players and the investing public in general in the New Zealand market, that the problems and inherent dangers of insider trading should be better understood.

Secondly, I believe that professional bodies such as the Accountants' Society, the Law Society and the Stock Exchange should each include, within their code of ethics, strong anti-insider trading provisions with necessary punitive measures for breaking those rules. As professional advisors, members of these groups will often become party to confidential information in respect of which temptations may arise. The pressure of threat to livelihood which professional groups can exert could indeed be a significant deterrent, to those who might otherwise succumb.

Thirdly, rules imposed within specific organisations themselves such as the Auckland Regional Stock Exchange, individual sharebroking or accounting firms, or financial institutions, can also act in a self-

policing capacity over their own staff.

One specific matter that I would take issue with and which has been raised in the paper, is the suggestion that brokers should act as a watchdog or a pseudo policeman on insider trading. I do not believe that it is a broker's role to make such judgments for his client. It is his role only to transact business as instructed provided that in so doing he follows the regulations of the New Zealand Stock Exchange and the requirements of the law in general. Apart from placing the broker in an impossible position I believe the total onus on whether or not the individual or corporate should be dealing in a particular company's shares rests with that client.

I am a firm believer in maintaining business and individual freedoms and while I am in no way suggesting that these freedoms should include licence to trade as an insider, laws and powers for investigation which restrict normal business almost down to watching with whom you are lunching, in my opinion are draconian and counter-productive to commercial realism and the greater balance we are trying to achieve in our society.

Dr Rider suggests most cases of insider trading surround acquisition, mergers and takeovers and I'd like to comment specifically on this area. Partial acquisitions and takeovers are a normal business activity, the process of which frequently involves the purchasing of shares to acquire perhaps up to 4.9% of a company (before the general market has knowledge of corporate intentions). I see this purely as a normal procedure in a free market where, quite often a decision to proceed or not to proceed, or how far to proceed in acquiring shares, is made during this initial acquisition process. To interrupt this process, by requiring disclosure to be made, would inhibit greatly the potential to complete the transaction in many cases.

As far as legislation is concerned, there are three points.

Firstly, the cost-benefit of a New Zealand legislative watchdog would need to be questioned, given the level and seriousness of any insider

trading which may occur. I believe that such an institution would need to have identifiable benefits to the community before the cost of its existence could be justified. Dr Rider records that in the seven years since the British law has been in place, only seven cases have come to Court. I do not believe that a hit list at that level would justify the expenditure of resources in New Zealand.

I am sure that there are many other areas of commercial law where funds and scarce professional resources could be better utilised.

Secondly, I believe there should be provision for the primary aggrieved party to take civil action to recover any direct damage it has suffered so that takeovers, acquisitions and mergers do not become as in some Commonwealth jurisdictions, nothing more than a barristers' benefit match. I believe it should be possible for the aggrieved party, ONLY, to seek compensation, for example, if company A was to takeover company B and persons in the latter with inside information purchased shares which moved the market up thus forcing A to pay more to acquire the company then A should have the right to recover the additional cost it incurred in obtaining its objective.

Moreover if people with inside knowledge of the transaction actively coerced holders to sell these shares then any sales should be reversible. However, I do not believe that individuals who sell shares to the acquiring company, where no coercion or advice has been used to purchase these shares from the vendor, have any case for compensation.

Thirdly, legislative action, over and above that already available, can always be reserved as a further course of action if the problem proliferates and if the principle of impede and hinder is unsuccessful.

In New Zealand the overwhelming influence on the whole issue of insider trading is that we are a small country and a small market place. Companies and individuals need to deal and have continuing contact with one another. Until a larger population or business community exists, there is insufficient space for malpractices of any significant consequences to occur. With greater size, sub-cultures can emerge. When that stage is

reached, and if the problem is widely apparent, the New Zealand situation can be reviewed, probably with more sophisticated and effective overseas experience than currently exists, available to help us.

In summary I believe:

- That through investor education and internal regulation of professional bodies steps should be taken to make all players aware of their responsibilities.
- That the New Zealand sharemarket has not experienced or suffered from widespread insider trading.
- That given the size and nature of our market any major abuse of this kind would be obvious.
- That market self-regulation would ensure that the entrepreneurs who were guilty of insider trading to the detriment of other investors would be brought into line by the treatment of their company in the market.
- That other regulations would only serve to stifle a healthy business environment.
- That companies or individuals concerned should be able to seek civil compensation to recover losses suffered.