INSIDER TRADING

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"THE UNACCEPTABLE INSIDER"

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No other topic has more significantly featured in discussion of company law and corporate securities regulation, over the last two decades than insider dealing. In many countries the debate on how to discourage this practice has dominated the discussion of how the capital markets should be regulated, in others the competence and effectiveness of regulatory structures and organisations have been judged, almost solely, in terms of their efficiency in preventing or discouraging insider abuse.[1] Although insider dealing has over the years meant many things to many different societies, in the present paper the term means the use by corporate insiders and their associates of confidential price-sensitive information,that they have obtained by virtue of their position,to make a profit or avoid a loss, by dealing in the securities of the relevant company. Of course,a broad view of insider dealing could properly comprehend a large number of practices which are considered fraudulent, manipulative or improper.

Insider dealing is not a new phenomenon. A Special Commission appointed by Parliament to inquire into malpractices in trade, reported in 1696 that sound business was being undermined by a series of abusive practices including promotional frauds, asset stripping operations, insider dealing and market manipulation.[2] The Commercial and Financial Chronicle of 8 February 1872 referred specifically to insider dealing being 'a very great evil'. History gives us many other instances, such as the case in 803 A.D. of the junior official in Tang China who was reported to the Imperial Censor for dealing on certain markets prior to the announcement of information by the Government which he was aware of and which he knew would influence the market price.[3]

Given the attention that has been given to regulating insider dealing in Australia and other Commonwealth jurisdictions, it is perhaps surprising that so little concern has been felt in New Zealand.[4] Of course, the subject has been discussed in New Zealand and insider dealing has been identified as an abuse which requires some form of control.[5] There would appear, however, to be a widespread feeling that the approach of certain other jurisdictions, particularly those with more developed and larger securities markets, is not, in the local context, necessarily practical or desirable.[6]

Whilst cases of insider dealing, apparently by secondary rather than primary insiders, have to come to light,[7] it seems likely that the extent of this form of abuse is not

considerable.[8] However, there is considerable potential for abuse given the nature of the corporate securities industry and in particular the number of interlocking directorships, multiple fiduciary functions and use of nominees.[9] The Courts in New Zealand have gone as far as any in the Commonwealth in providing civil liability for insider dealing in direct personal transactions.[10] The Securities Commission and the Stock Exchange have long recognised the importance of effective timely disclosure of material corporate developments. The Stock Exchange has also set out guidelines for directors' share dealings in the securities of listed companies.[11] The only relevant statutory provisions, however, are those relating to the disclosure of directors' dealings in the securities of their own companies and the various powers of investigation that are entrusted to the Securities Commission and Registrar of Companies. The Securities Commission, has recently announced that it intends to review the present law relating to insider dealing[12] and it is with this in mind, that the present author has prepared this paper. Far too many jurisdictions have rushed into a form of regulation, which is either not effective or in fact discourages the development of the very markets that they seek to protect and advance.[13] Sadly, in a good proportion of these cases other countries' legislation has been adopted without proper, or in some cases any, regard to the special circumstances of local conditions.[14] To attempt to devise effective and cost efficient control mechanisms without a clear idea of the local conditions and in particular the practical and institutional constraints is entirely counter productive.[15] Furthermore, far too little attention has been given to rationalising the policy behind insider dealing regulation.[16] Too many have simply sort to regulate insider dealing on the mere assumption that it is 'bad'. Others have justified regulation on the basis that such, like a Securities Commission of some kind or other, stating control is in vogue. Consequently, this paper attempts to justify regulating insider dealing according to accepted public policy criteria. It then discusses some of the practical issues facing those charged with regulating this practice, and proffers certain suggested lines of attack. Given the interest that has been shown in the British legislation in New Zealand, the provisions of the Company Securities (Insider Dealing) Act 1985, as amended by the Financial Services Act 1986, are discussed in some detail. It is, thus, hoped that this paper will contribute in some small measure to the current debate in New Zealand.

WHY REGULATE INSIDER DEALING?

Over the last few years considerable discussion has taken place on whether the practice of insider trading should be the subject of statutory regulation or not. Notwithstanding the amount of debate that has taken place, little, if any, empirical research has been conducted anywhere as to the likely incidence of insider dealing. It would certainly appear from

the cases that have come to light on relatively developed securities markets that it does occur, and it can be reasonably assumed that its incidence would be all the greater in less developed markets.

A slight indication of the probable incidence may be gleaned from statistical evidence that is available as to insiders' own views on the utilization of privileged confidential information for the purposes of trading in securities. Although there have been strict anti-insider trading laws in the United States of America at least since 1934, in a study conducted by the Reverend R C Baumhart,[17] of some 1700 corporate executives 42 per cent said that they would trade personally on inside information, and 14 per cent said that they would give the information to a friend. Perhaps more interesting was the response to a question about what the executives thought other company executives would do in such a situation. Here 61 per cent considered that the executive would use the information for trading, and 46 per cent considered that he would pass it on to a friend. A similar study was conducted in Britain in 1971 by Simon Webley.[18] Of some 830 executives, 24 per cent said they would trade on inside information, but only 2 per cent said that they would pass it on to a friend. It is not without interest, however, that when asked what they thought company directors would do in such a situation, only 12.5 per cent thought that the director would trade. A more recent survey in Wall Street by Business Week August 1986, showed that most of the ,yuppies, canvassed thought insider dealing should be illegal, but over 80 per cent admitted they would be prepared to do it - out of 'pure greed'. The overwhelming majority accepted if they did decline to transgress it would be more on the basis that the 'tip, might not be reliable, than would be more on the basis that the because they thought they might get caught. Indeed, again 80 per cent thought that the recent expensive - in diplomatic as well as cash terms - anti-insider dealing campaign in the US made no difference to their decision. Although these surveys are of some interest, one must resist attaching too much significance to them.

Assuming that insider trading does occur, the problem then arises whether it is necessary and desirable to circumscribe it or, indeed, prevent it. This problem cannot really be resolved by purely moral considerations. Given the significant resources that need to be employed to effectively regulate insider dealing it is important that careful attention be given, to a variety of economic, social and political considerations, before resolving on the form of regulation or for that matter whether regulation is desirable. Unfortunately, in many jurisdictions such deliberation has not occurred and consequently in some the devices erected to regulate insider dealing are inefficient and possibly even detrimental to the market.

Let us explore some of the 'policy' considerations:

Fairness

Lawyers and politicians seeking to justify regulation of insider trading invariably resort to the notion of fairness. Exactly what this concept means in the present context is a matter for debate. Certainly the blind assertion that insider trading is unfair answers little. On the other hand it would seem probable that the great preponderance of public opinion, at least in the United Kingdom and United States of America, considers insider trading immoral and unethical. In a random survey conducted in the spring of 1975 in New York, Toronto and London 71, 69 and 74 per cent respectively of the sample thought insider trading immoral.[19] Admittedly it would be wrong to place any great weight on such statistics. None the less, it would be equally wrong for governments and legislatures to disregard the strength of public feeling on this issue. It is of course true that many members of the ordinary public might be unaware of exactly what the term insider trading means, but the essential characteristics of the practice are easily enough appreciated. Those outside the business world probably hold stronger feelings about the impropriety of insider trading than those in the mainstream of everyday corporate business, and while this is not surprising there is some force in the caveat that the source of hostility to insider trading is mere human jealousy.[20] Out-siders do not necessarily object to insiders making a profit through insider dealing but rather are aggrieved that insiders are in a position to use the system for their own personal benefit, whilst they are not themselves so well placed.

The lawyer's approach must be more sophisticated. Although there are always uncertainties, and indeed an element of pure chance in trading in corporate securities, as a matter of fairness both the insider and outsider should have equality of opportunity and bargaining position. The lawyer deems it unfair that the insider should have an advantage over out-siders based on superior access to company information. This ascendancy, not being attributable to any industry or merit which might otherwise justify the advantage of the insider, may be considered improper. The contention that a corporate official should not be allowed to take advantage of his position and the legal privilege this gives him to acquire corporate information is very different from asserting that there should be substantive equality. Fairness here may be related to equality of bargaining position or opportunity, but beyond this there is admittedly a vast area of potential inequality where the law cannot venture. Considerable juristic thought has been spent in attempts to rationalise concepts such as equality and fairness, but in the result it appears that the acceptance or rejection of these notions as legal tools will depend upon the a priori judgement of the assessor. Equality of bargaining position as a legal concept has acquired more

than a foothold in the common law. There is evidence that it will be applied by the Courts unless some higher principle intervenes to render it inapplicable as a juristic tool.[21]

The privileged position of an insider over an outsider may or may not be justified on a number of grounds. Although it may be argued the insider's trading advantage is illegitimate in that he did not acquire the privileged information through any intrinsic merit in himself, this ignores the argument that his insider status was acquired in the first place through industry and merit. Furthermore, the same economic and social system placing the insider in this position of ascendancy over the outsider will also accord him other financial privileges, which are not necessarily regarded as unfair. When one considers the significant trading advantages enjoyed by large investors and the superior research information that 'better-off' investors can purchase, is it not rather shallow to speak of equality of opportunity?

Professor Manne has criticised resort to the principle of fairness, and considers such an approach as hypocritical and self-righteous.[22] The American Congress, in providing stringent anti-insider trading provisions, neglected to pay proper regard to the arguments of logic and economic policy which point to the advantages of unregulated insider dealing, in Manne's view. Whilst the various Congressional statements advocating anti-insider trading legislation are emotive it is not without interest that invariably the notion of fairness is spoken of in terms of a betrayal of fiduciary responsibilities. Thus, it would appear that the pronouncements against insider dealing criticised by Professor Manne did not entirely derive from irrational self-righteousness, but rather from a recognition that accepted and well-defined legal relationships had been abused. There is both logic and authority for regarding corporate insiders as fiduciaries and therefore applying already existing and well-tried equitable principles. How far these principles are themselves the product of fairness concepts is irrelevant, as they are now accepted legal norms. Even where the condemnation of insider trading is based more widely upon the notion of unfairness rather than betrayal of fiduciary duties, in practice regulation is directed solely at those who might be said reasonably to occupy a fiduciary or confidential relationship.

Professor Manne argues that it is inappropriate to regard outside investors as in any way beneficiaries of the insider. In Britain and New Zealand it is probable that the law would not recognise a fiduciary relationship between a corporate official and a shareholder arising solely by virtue of their corporate relationship.[23] But, even if a strict trustee relationship is inappropriate the so called 'secret profits' rule, and the rule directed to the avoidance of conflicts of interest, would curb the insider's self-dealing on

accepted legal principles.[24] Moreover, if the inside information is recognised as property belonging in equity to the company, the trust analogy does have meaning and, from the standpoint of equitable remedies, great significance.

Resort to the notion of fairness has also been attacked on the ground that the law can never ensure complete equality of information, and the inevitable discrepancies in information are one of the inherent risks that traders on a securities market must accept. Indeed, economists accept that in a fully efficient capital market there is no opportunity for an investor to make abnormal returns from information he might have access to legitimately as it will already have been discounted by the market. Thus, if he is to aspire to greater rewards he will be forced into attempting to capitalise on whatever inefficiencies exist in the market - and in particular the utilisation of 'secret' or 'inside' information. Professor Manne underlines this argument by describing securities markets as essentially exchanges for information, the market placing relative values on particular types and qualities of corporate information.[25]

The most significant attack on the traditional approach to insider trading regulation in the United States by Professor Manne and his followers has been frontal. He asserts that the 'insider's gain is not make at the expense of anyone'.[26] Insider trading is only a very small proportion of total market trading. Furthermore, only a very small proportion of outstanding securities are actively traded anyway. It is thus argued that the scope of the problem posed by insider trading on privileged information in relation to the market for shares in the particular corporation will be negligible. There is virtually no room for insider trading to affect the market price of actively traded stock. The shareholders who do not in fact trade at all are not injured by insider dealing. Where the information is good, by retaining their shares they will eventually benefit from the increase in market value. It is only the shareholders who sell out just before the announcement or disclosure of significant information who can be said to have suffered. The loss that a selling insider sustains will be the difference between the price at which is transaction was effected and the price at which the transaction would have taken place had the information been generally available. It might thus be argued that as the effect of the insiders trading is to bring about a gradual increase in the market price of the securities, in line with the proper value of the security, the insider by dealing benefits the class of selling shareholder by reducing the average loss. Professor Manne also seeks to distinguish between the outsider who trades in response to price changes and one who trades as a function of time. The latter, selling for essentially personal reasons, would presumably still do so even if he knew the market price might rise. Insiders' acquisitions will arguably benefit such a seller by raising the average market price to a point nearer to

the proper value. The fact still remains, however, that the shareholders who dispose of their securities prior to disclosure of the inside information have been damnified. Market traders who deal on the basis of the market and not primarily for personal or extraneous reasons can also be regarded as having suffered in that they would almost certainly not have traded had they been aware of the insider's information. It might not be necessarily fair or indeed logical to place responsibility on a trading insider for their failure to select the most propitious time to trade. Where there is evidence that the insider deliberately controlled the corporate disclosure mechanism to serve his own personal trading the position would be different. There is, therefore, at least some weight in Manne's contention with regard to loss allegedly caused to outsiders by insider trading.

> "It is simply not enough to say that it may on occasion happen. The truth is that for any individual with whom we are concerned, the absolute odds in favour of his losing anything as a result of insider trading are so small as to be unworthy of serious concern."[27]

It is unfortunate that Professor Manne does not really deal with the situation where an outsider acquires securities from an insider, or in a market in which the insider has sold, whilst in possession of bad information. In a market context it is likely that the outsider will already be in the market ready and willing to trade at the market price with anyone. If he does not trade with the insiders he will buy from someone else. Where a corporate insider sells his securities on the basis of bad information there is no room for Manne to argue that it is only the short-term speculator who is hurt. Indeed statistically the short-term speculator is likely to suffer least in such a situation.

Thus, although Manne is justified in attacking the great reliance placed on the concept of fairness, in the context of market transactions, as it is extremely difficult to identify any specific harm to any individual trader, this neglects the wider issues of fair dealing. Essentially the question is whether an insider should be allowed to pass on a loss to another, or take a profit, by taking advantage of privileged information, in the absence of any compelling reason of public policy justifying it.

Therefore, to justify anti-insider trading regulation on a basis of fair dealing it is not necessary to establish direct loss or injury to an individual either in real or notional terms, causally related to the insider's trading and gain.

The effect of Insider Trading on Corporate Management

It has been argued that insider trading is necessary for the efficient and economic management of companies. The most

astounding suggestion is that insider trading may be regarded as a legitimate reward for entrepreneurial ability, and thus a stimulus to the inventive mind. Manne, the main exponent of such an argument, considers that entrepreneurs are a distinct class of people and readily identifiable from mere managers or capitalists. In the present context he considers the entrepreneur as an innovator can be just as much in evidence in the world of finance as he can in manufacture. It is argued that only the prospect of large capital profits acquired through share dealing will be sufficient compensation and stimulus to the inventive mind. It is of course true that asset-strippers and their more respectable counterparts are not likely to indulge in costly corporate reorganisations without the prospect of sizeable capital profits. Nevertheless, as a general principle validating insider trading as a legitimate factor in modern capitalism the argument has come in for a great deal of criticism. Here, it is only necessary to refer to the more obvious criticisms. In a modern corporation it would be extremely difficult to identify any single person or, indeed, group of persons who might properly be regarded as entrepreneurs in the traditional sense of that word. Even if such a class was readily identifiable the problem of how to create a scheme for the deliberate exploitation of inside information would arise. Entrepreneurs are likely to have limited personal resources and may therefore be unable to take proper advantage of what Manne would consider to be their legitimate entitlement. Unless the entrepreneur had full access to all corporate information, and an ability to translate it into investment information, he would be unlikely to make consistent profits through share trading. If it was accepted that the mere prospect of vague and uncertain future profits could be regarded as a form of entrepreneurial compensation, Manne's thesis could hardly be supported, where the insider attempts to sell out when his entrepreneurial efforts have failed. It is true that Manne takes a much broader view of what constitutes insider dealing. In his opinion the selling and exchange of inside information is just as important as direct trading on the basis of inside information. Thus, in his view 'cashing-in' on information, through 'selling' it to another or exchanging it for other 'inside information' might enable the favoured few to stay ahead of the market. Unfortunately, it would appear that Manne's view of 'inside information exchanges' and mutual backscratching' arrangements is not purely academic fiction. Recent cases in the United States and Britain have dramatically attested to the existence of such syndicates, especially in regard to information relating to takeovers and mergers.

In Britain it is possible to find at least some evidence to support Manne's arguments. Certain companies, in particular finance and investment companies, have in the past promoted personal share-dealing companies, invariably based abroad, for their executives, the justification being that of executive incentives. A rather notorious example of this is Slater

Walker Securities and its various Far Eastern share-dealing companies. Where an economy is in a state of depression and there is also a significant rate of inflation, normal executive salaries are admittedly likely to prove an insufficient incentive. But alternatively few are likely to have the capital or credit to risk speculative share trading in the depressed capital markets. Furthermore, it would only be in exceptional circumstances, that the average executive would have possession of the kind of sensational information that would almost certainly bring him substantial trading profits.

It has also been argued that the prospect of liability, and in particular the crushing civil liability arising through regulation of insider trading, would deter eligible persons from accepting appointments as company directors and officers. Whether this is true or not remains to be seen. It is true that in the United States of America a great deal of managerial effort and time is occupied with litigation and threats of litigation. It would be misguided to attribute this situation to the American laws regulating insider trading, or, indeed, any difference in substantive law. The answer lies in the greater availability of the class and derivative actions, the widespread use of contingency fees by lawyers and the difference in costs procedure.

There is, however, evidence that many firms of stockbrokers and merchant bankers are now actively discouraging, and in a few instances prohibiting, their senior officers and partners from accepting insider positions in public companies. From the standpoint of anti-insider trading regulation this is probably salutary, as is the move to restrict the number of company directorships a particular individual may hold at any one time. However, where managerial skill and specialised expertise is scarce or limited, such a trend may be undesirable on economic and social grounds.

Undeniably, there is a clear need for the law, whatever it may be, to be certain and unequivocal with regard to insider trading. The position of professional fiduciaries in possession of material price-sensitive information is precarious,[28] and it would not be reasonable to impose upon all corporate insiders the additional burden of vague anti-insider trading laws. Provided the regulation is reasonably precise, to avoid the possibility of liability a company insider should simply refrain from trading in the relevant security whenever he happens to be in possession of material undisclosed information that could be expected to affect the price of the particular securities. Admittedly where a single person holds a great number of corporate directorships the prospect of jeopardy is much greater, but this is a calculated risk he has chosen to accept.

It is generally thought desirable to encourage directors to hold equity shares in their companies to promote an

identification of fortunes with the ordinary shareholders. It has been argued that the effect of anti-insider trading regulation would discourage directors and officers investing in their own companies and thus lead to a consequent lack of financial identification with the fortunes of the company. Given the increasing recognition that it is not only the providers of equity capital who have a direct interest in the financial well-being of the enterprise, but also those, for example, who provide labour, it is open to question how much weight should be attached to this argument. For most company executives continuation of quiet employment is of far greater importance than the invariably minor amount of capital investment they might have in their company. In any case, given the dimensions of modern companies it is unlikely that directors' and officers' shareholdings are going to be more than a small proportion of the equity capital. Socially there is much to be said for an individual not having his savings invested in his employer. If the corporate employer fails through no fault of his, it is hardly fair or desirable that he should lose both his job and his savings. None the less, the solution for insiders who wish to invest in their own companies and also avoid allegations that they have indulged in insider trading is easy enough. They should simply not trade when in possession of inside information, or alternatively commit themselves to a firm investment plan which they cannot alter or influence.

An argument advanced in favour of anti-insider trading regulation is that if insiders are allowed to trade freely on the basis of corporate inside information there will be an incentive for them to manipulate corporate developments and news releases so as to accommodate their personal dealings. The Congressional Committees investigating the collapse of the North American securities markets in the 1920s found evidence of directors timing corporate disclosure for the benefit of pool operations. How far this occurs today is uncertain. Improved market surveillance on most stock exchanges would substantially reduce the scope for such operations. Furthermore, many large public companies are not today in complete control of their own disclosure programme. Certainly very few corporate executives would be in a position to influence the timing or manner of corporate disclosure. Insiders can obtain significant trading advantages by immediately dealing on the release of the information. Far more likely than the deliberate delaying of corporate announcements by company executives is the intentional distortion of news by issuing misleading releases. A company executive will probably have considerably more scope to distort news releases then withhold them. This is particularly so where the information is of a technical nature. Where misleading disclosures are made the law does of course provide remedies.

North American courts have occasionally attempted to justify insider trading liability on the basis of the harm that this does to the company's reputation, and, thus, indirectly to its commercial operations. As a general proposition this goes too far. Obviously a great deal will depend upon the particular circumstances of the case. Consumers are more likely to be concerned with the reputation of a particular product rather than the integrity of the company's executives. Suppliers, to the extent that their direct dealings with the company's management are far more significant, may be more concerned about the integrity of the company's executives, but it is more likely that the crucial factor will be the company's credit-worthiness. It is in the area of financing that the impact of loss of reputation is more acute. It has been suggested that a public company which has acquired the reputation of being an 'insider's company' may well experience trouble in obtaining further capital from the securities markets. There is no convincing empirical evidence that this is in fact the case. It is probable that a private company with such a reputation would experience considerable difficulty in finding sufficient financial backing to go public and similar problems might arise with regard to sponsorship of application for a Stock Exchange listing. Professionals and institutions of standing in the securities industry might not be willing to become associated with managements of dubious integrity. Another important consideration is that allegations of insider trading by management might well injure industrial relations. But in all cases very much will depend upon the reaction of the company's management to the guilty party. Prompt condemnation and, where appropriate, disciplinary action may well in practice improve the company's reputation for integrity. A company's reputation may be of importance when seeking governmental assistance. Political considerations may well result in the Government being unwilling to co-operate and support a management with a tarnished public reputation. Similarly, a company which has had its reputation injured in this way might find difficulty in dealing with foreign governments and other companies. In practical terms it is probably true that damage caused to a company's reputation by allegations of insider trading by its corporate executives is largely theoretical. The only direct consequence is likely to be a disruption in internal managerial relations.

Directors and company officers owe certain fiduciary and contractual duties of loyalty to their corporate principals and it may be argued that if they are allowed to indulge in unrestricted insider trading there will be a diversion from the pursuit of the company's objectives. Again this argument goes too far. Corporations are not, in the absence of very special contracts, entitled to the full and undivided attention of their directors and officers. Directors, of course, subject to the provisions of their service contracts, are only bound to give reasonable attention to the affairs of their companies. It has been suggested that directors are under a fiduciary duty

to use all information coming to them in their position as corporate agents for the benefit of the company. However, as in the case of other fiduciaries, this cannot impose a duty upon them, except in the most unusual circumstances, to actually engage in insider dealing. This is even more the case where the profits is to be made in the securities of the director's own company. In most systems of company law, companies can only 'deal' in their own securities in the most exceptional circumstances. The difficulty here is in deciding just how far it is reasonable to cast the regulatory net. It is debatable whether a company should be bound to declare its intention to make an offer for the securities of another company immediately upon deciding to embark on a takeover bid. On the other hand, should it be allowed to build up a foothold in the target company before making its public announcement? If a company does do this, or indeed engages in warehousing, the acquisitions are made on the basis of privileged information, albeit merely the company's own intentions. Another problem area is where an investment company decides as a matter of independent judgement to move into or out of a particular security. The advance knowledge of the probable market impact of such a transaction would be highly price-sensitive. The difficulty with penalising companies for trading on the basis of their own intentions is that the result is to penalise financial diligence and superior economic analysis. One of the rewards of instigating a corporate reorganisation or rationalisation is the capital profits made on the relevant securities. This has traditionally been considered a legitimate reward for the time and effort that have been expended in bringing a corporate reorganisation to a successful conclusion. Furthermore, the information here in question is created solely by the company concerned and does in a very real sense 'belong' to it.

To allow insiders to trade on the basis of privileged information destroys the identify of financial interest existing between the insiders as investors and the remainder of the shareholders. Furthermore, the ability to engage in unrestricted insider trading may well make insiders less prepared to take all the necessary steps to avoid a financial collapse of the enterprise. If the insiders can offload their securities at what is in effect an inflated price, there is less incentive for them to 'make a go of the company'. How much weight should be attached to this argument is open to question, given the importance to most executives of security of employment and the relatively small investment they are likely to have in their own company.

The effect of insider trading in the Securities Markets

Professor Manne has argued that insider trading actually renders the securities markets more efficient. By an efficient market, economists generally mean a market where there is a high degree of absorption of pre-release information and thus a

gradual adjustment of price rather than a series of violent price fluctuations.

The stock market must be such that the best interests of the investor are to be served. There is no controversy on that score. There is, however, controversy on what type of stock market does best serve the investor. The emphasis of some writers is on the necessity for efficiency in the running of the stock markets as a whole. The emphasis of others is on the necessity for having a market that will attract investors, for, without the attraction of their capital, the capitalist system could not operate. The role of insider trading is said by some to make the capital markets run more smoothly. Others stigmatize it as being one of the major factors that have, in the past, deterred investors from entering the stock markets.

Because the argument that insider trading produces efficiency has been often and so strongly put, it is proposed to deal specifically with it. The investor, on this argument, is best served by having an efficient stock market: one free of violent fluctuations in prices where there is a continuity of transactions and in which prices are as near as possible at their correct levels, that is, levels which reflect their actual value.

First, it is contended that insiders, by making use of their special information and buying when share prices without good cause are declining and selling when prices are artifically high, provide continuity in the prices of shares. The assumption is made again, of course, that the insider transactions are of sufficient influence to arrest the trend. It is likely that this will occur only in rare cases.

Manne also claims that there are violent fluctuations without insider trading, but that with insider trading there is continuity and a gradual escalation or de-escalation of prices. His graph illustrates what he thinks is the comparison between the two situations. Without insider trading, he asserts, after the announcement of the relevant facts there will be an immediate rise or fall to the peak or trough of prices. He implies that without insider trading the direction and magnitude of price changes in shares would always be uncertain and there would be no discernible dependence of one transaction price on the immediately preceding price. The only thing that can counteract this and produce some continuity, or dependence of one transaction on another, is knowledge. The one effective type of knowledge in Manne's view seems to be that of specific facts rather than the general knowledge of the company's affairs or of conditions in the industry concerned which might also affect prices.

Manne divides all traders into those who have reliable information, among them being insiders, and those who do not. Those who have reliable information will buy as much as they

can as long as the market price is below the level to which it can be expected to rise on publication of the information. The others will act according to price or time or a combination of both. The activities of the 'know-nothings', as he calls them, will be largely random, will not influence share price movement and will cancel one another out.

It is argued that transactions based on insider information draw other transactions towards them, and that formerly random transactions are drawn towards correct levels. This occurs because outside sellers will sell to the insider when the price offered is more than the price outside buyers are offering. And as transactions are a function of price, some outside buyers and sellers will now buy from and sell to each other at a higher price. Outsiders who did not purchase shares, but who would have done so had they known the facts, are not damaged, because, had they known them, the price would probably have risen before they could have acted upon the knowledge, and it would no longer have had any value. Whilst it may be assumed that insiders could influence price trends, there is no empirical data provided by Manne himself which proves that they determine them.

Allied to this is the contention that insider trading draws the prices of securities towards a level which accurately reflects their true or underlying real value. The more 'knowledge' in a share transaction, the more likely it is that share prices will be near the levels at which they should be if all facts about the company were adequately digested and understood. The alternative method of providing for as nearly complete knowledge as possible in transactions, that is, full disclosure of material facts, is rejected as being unfeasible, though just why it is not possible has not been the subject of extensive debate. Available evidence suggests that insiders may influence the market but that they do not determine trends, save in the most exceptional circumstances.

In any event, it is not satisfactorily explained why it is better to have gradual price movements. It is not universally agreed that it is better to have a sequence of transactions at prices which change gradually than in jumps. Even if it were agreed that continuity is desirable, a practice which produces it could well be undesirable on other grounds. The opposite may in certain circumstances be desirable: stock exchanges sometimes suspend transactions till news is adequately disclosed and digested. If sharp changes are brought about by all investors having equality of access to adequately disclosed facts, it is probable that most people would think this the lesser of the two evils, if the lack of continuity be deemed an evil at all.

The arguments for free insider trading based on continuity and the bringing of share prices towards their 'correct' level are arguments of logic. Their prime

propounder, Manne, does not refer to any empirical studies on these questions, nor has he presented any of his own. He could and should have referred to empirical studies; they would have indicated that the influence of insider trading on the stock markets is far from a dominating one; in fact, the pressure which insider trading exerts is almost negligible. This casts doubt on Manne's contention.

In the first instance, in a doctoral dissertation Wu in 1963[29] found that, in regard to trading volume, insiders are relatively inactive in the market and were so even in the late 1930s. In a five-year period from 1957 to 1961, insider trading, excluding gifts and options, amounted to only 1 per cent of the total trading volume, and trading of offices and directors as a group amounted to 0.9 per cent of the total. No evidence of general trading induced by insider trading was found.

The second study to which casts doubt on Manne's thesis is an unpublished doctoral dissertation by Fischer.[30] Here the empirical evidence consisted of open-market transactions of insiders in stock of their respective companies. Data from insider transactions from thirty-six companies were analysed from the official summary of securities transactions and holdings of the United States Securities and Exchange Commission. Fischer found relatively few insiders engaged in transactions in stock. Also he found that mostly ,their transactions were not importantly related to price movement'. This probably shows that there is also little trading induced by insiders.

Thus, even allowing for the fact that in the United States there are considerable restraints on insider share holdings, it appears that insider trading has no significant impact on market prices. One reason perhaps is that the insider will always be constrained by considerable limitations on the amount of capital and credit he can obtain. It is unlikely that insiders can obtain sufficient resources to raise the price to even near the point to which it will rise on public disclosure.

The empirical data referred to above would seem also to render invalid the theory that prices are enhanced through insider trading increasing the number of transactions in a given company's shares.

The contentions that free insider trading means continuity in the market, increased benefits for shareholders, and prices of shares which reflect their true values, are put forward principally by Manne. In his view the United States should abandon the restraints which are now in force, lest it should be 'tampering with one of the wellsprings of American prosperity'. He sees the whole structure of capitalism threatened by restraints on insider trading - but he does not

see that capitalism could be threatened by the possibility that investors might be deterred from investing because of insider trading. The question of the effect of unrestricted insider trading on the quantity of investment by the public is not canvassed by him. He maintains that the public is better protected by having an efficient stock market than by having a fair one. The very notion of a fair stock market he regards as both illogical and meaningless.

Admittedly, there are no studies on the effect either way on the mind of the investor. The overwhelming preponderance of opinion, however, is that insider trading acts as a deterrent to investors. The security market, according to one view, serves three functions:

(a) it provides a ready marketability for securities;
(b) it yields prices for securities that are in accordance with their investment value;
(c) it acts as a medium for channelling capital into economic development.

The last is, of course, essential to the economic structure and to prosperity. In 1929 the American securities market failed to fulfil its purpose partly because of manipulation (with the allied problem of insider trading playing a part), and the effect on prosperity was cataclysmic. In 1929 speculation was based, not on the future worth of the company, but on special facts. The extent of the part played by insider trading in 1929 is uncertain. That it played some part is not questioned. The importance of the shareholder in the capital market in 1929 was brought to the fore, and integrity in the capital markets was seen to be essential to mass capitalism.

Most writers agree that public confidence is the prime requirement for an effective stock market. If the investor loses confidence he will simply not invest, with the result that companies will not get capital. The aim of all stock exchanges is to draw the public into the market, and for confidence to be established the stock market must be, and must be seen to be, a safe place for investment.

There are many types of situation that might deter an investor; those pertaining to insider trading are:

(i) the possibility that shares will not reflect their objective value;
(ii) the possibility that there are a favoured few in the stock market who are never hurt; and
(iii) the possibility that there is not a high standard of ethical conduct by management.

These will be discussed in turn.

(i) According to one writer,[31] capital markets depend on a liquidity which rests on investor confidence that current quotations accurately reflect the objective value of the investment. This is in direct conflict with Manne's view that prices are drawn towards correct values by insider trading. However, it is hard to see how the price at which any insider is trading could be closer to the correct value than would be the case if the insider, instead of trading, had made publicly known all the material facts of which he was apprised. The former view is preferable. Even if what Manne said were to be true, there is the axiom that prices must seem to reflect true values. If an insider makes a profit or avoids a loss, it would appear to an outsider that, at least at the time of the transaction, the prices did not accurately reflect current values. Markets, like the law, must seem to do equity. Otherwise the public will lose faith in them.

(ii) The investor realises that there are elements of risk in investing. But he does insist that all who are investing be subject to the same chances. If a class of investor is exempt from the inherent vicissitudes of the market-place, the public is justifiably perturbed. As D M Feuerstein has observed,'[t]rading advantages for the favoured few and confidence of the entire investing public are not compatible'.[32]

(iii) It is essential that investors trust the management of the companies in which they invest. The investor has an established interest in the integrity of management as well as in their ability. Insider trading and manipulation go hand in hand. The investor must be certain that the basis of every decision of managers is the interest of the company. If the way were open to managers to profit themselves by their decisions, there would be an undesirable effect on the mind of the shareholders. Again, fairness must be seen to be done. Even if managers are ethical, the public should be assured that there is no possibility that managers, in making a decision, might have any motive other than the interest of the company.

With the above three factors in mind, one finds it difficult to refute the connection that unrestricted insider trading will deter investors. The only point of real controversy is the extent to which such abuses might discourage investors coming to the markets. It may well be questioned whether the cost of adequate anti-insider regulation in this light is worth the results that may be achieved. This determination must be essentially one for the politicians. The impact that disclosure of the occurrence of such abuses as insider trading might have on foreign investment is likely to be more significant than the impact it might have on domestic investment. Domestic investors usually have little alternative to investing on their own domestic capital markets, if they choose to invest on capital markets. International investors have a greater degree of flexibility. Furthermore,

international investors might feel that the geographical proximity of domestic investors affords them at least some degree of protection that they, the international investors, do not have. Certainly the speed at which investors receive corporate disclosures and can execute transactions on the market is a critical factor.

Manne has argued that the presence of insider trading in the market would be no deterrent to investors who plan to hold on to their shares for a reasonable length of time. Manne considers that it is only the short-term trader, who is often a mere speculator, who is hurt by insider trading. Long-term or serious investors are less likely to sell their securities because of price fluctuations caused by insider trading. Such investors will liquidate their investments because of changed financial circumstances or such events as death. Manne further argues that the long-term investor may even benefit from insider trading. According to this argument the average market price is likely to be higher, with insider trading causing a gradual price adjustment in the market. Manne's argument is stated thus:

> Let us assume that a stock is selling at $50, with undisclosed good news which will ultimately cause the stock to sell for $60, and that no factors other than the good news will affect the price. Suppose further that with insider trading the price of the shares rises gradually to $60. The average price at which the shares sell during this period is somewhere in the neighbourhood of $55 (more or less depending on the shape of the time price curve). At $60, anyone who held his shares will have received the full benefit of the new information whether it is disclosed to him or not. This advantage to the ultimate holder remains even if we effectively prevent insider trading. Without insider trading, however, the position of those who sell during the time required for the price to rise from $50 to $60 is radically altered. No longer do they receive an average price of $55. Assuming that the ultimate disclosure is made at the same time under either rule, they receive only $50 for their shares without insider trading. In short, they get less than they would with insider trading.

Whilst no doubt logical, this argument is unsupported by any empirical evidence. Furthermore, Manne's argument is undermined by efficient ,timely disclosure'. The long-term investors who do decide to liquidate their investments during the period of non-disclosure do lose. Furthermore, Manne admits that the short-term trader, who is vital for the liquidity of the market, will be hurt. Anyone who trades during this period and as a consequence receives less than he would have obtained after disclosure is likely to feel cheated. It is this consideration that is important from the

standpoint of the market's reputation for fairness. Public confidence in the integrity of the market is a far more significant factor than Manne's theoretical arguments of logic. The widespread feeling of unfairness cannot be disregarded. As one commentator observes,

> a fair scheme does not allow speculators to be thrown to the wolves, high as may be their willingness to take risks - even the gamblers at Las Vegas are entitled to unloaded dice.[33]

In an economic system where the prosperity of the individual is tied to the prosperity of corporations it is important to minimise those activities which cause harm to corporate enterprise. Manne has argued that insider trading is of great importance to the well-being of capitalism. It avoids dramatic price fluctuations on the capital markets and leads to gradual adjustments of price in accord with real values. Furthermore, it increases the number of transactions on the market, thus increasing liquidity and generating ancillary commissions for the securities industry. Insider trading also rewards entrepreneurial ability and provides an incentive for innovation. It would appear that the more acceptable view is that insider trading is in fact a blemish on the face of capitalism. Apart from its detrimental effect on public confidence in the markets, which leads directly to an undermining of the capitalist system, it denies the individual's reasonable expectation of fair and equal treatment. Moreover, insiders are distracted from their corporate duties and functions and tempted into subordinating the interests of their company to their own personal interests. It is the aggregate of these points which persuades the present author that insider trading on the basis of privileged information forms no part of acceptable capitalism.

There are other and perhaps more sinister aspects to insider trading. Reference has already been made to the existence of syndicates dealing in and exchanging inside information. Sadly, there is also evidence that organised crime has also recognised that exploitation of inside information is a low risk and high return business. In one recent case a 'Wall Street' lawyer passed inside information, through his girlfriend in Hong Kong, to a number of 'investors' in the United States. He was paid in cocaine from an organised crime family. There have been other cases where organised crime groups have deliberately set about acquiring privileged information often through, extortion, penetration and deception. Thus, one is not dealing simply with Professor Manne's 'honest' entrepreneur, but in a disturbingly high proportion of cases gangsters and money launderers. Thus, the danger of alienation of society from the stock market is all the greater and a more pressing concern.[34]

THE JUSTIFICATION

Thus, it would appear that there are a number of valid reasons and principles, currently accepted as proper determinants of social policy, which would justify the imposition of inhibitions on insider trading. The call for regulation is not merely an illogical response based on vague notions of fairness and morality. Factors which influence public confidence might not necessarily be articulated in a logical expression, but the need to eliminate abuses in the market follows on logically from the recognition that it is imperative to preserve public confidence.

The determination how best to preserve confidence .in the integrity and efficiency of the markets will depend upon a host of factors. The law is only one tool available. In certain circumstances non-legal devices may achieve greater effect. Regard must also be had to the critical cost benefit of regulation. The price paid in financial and other terms may be too great. A sense of proportion is critical. Insider dealing is detrimental to the market because it undermines confidence, however, there are other threats to the market which may be more serious. The need to preserve confidence justifies action against insider dealing it does not resolve what form this action should take.[35] Indeed, a cynic might conclude that the best way to protect the reputation of the market is not to draw attention to abuses such as insider dealing. Given the difficulty all jurisdictions have faced in regulating this abuse, it may, be that this approach has a simple cost effectiveness.

THE REGULATION OF INSIDER DEALING

Having accepted the justification for regulating insider dealing, the question of how to discourage this abuse, must be answered. There is no panacea. There are ways in which insider dealing may be inhibited - rendered more costly and risky for the insider, but there is no single or set of devices which will ever eradicate the abuse entirely on a market which would still retain the primary characteristics of a market. Politicians, often reacting to scandals and, thus, an attack on confidence in the market, invariably fail to realise this. Unfortunately, lawyers tend to take a blinkered approach and deliberate the problem solely in terms of traditional jurisprudence. In the present author's view insider dealing can only be substantially impeded by an assault across a broad front. Like most forms of 'commercial crime' it has to be recognised that the insider's motive is to make a profit. Thus, by making the 'earning' of this 'reward' more expensive and by exposing the insider to more obstacles, the determined may be persuaded to give up. How can we make insider dealing more unattractive?

1) Education

As in other areas of economic activity, education, especially in regard to ethics, can play a very significant role. The realisation by those in positions of trust of the real damage that such activity as insider dealing causes on the system of social and political values, that they may be expected to generally espouse, can be a salutary device in conditioning an appropriate attitude. Rendering certain activities subject to self-regulatory constraints often inherent in so called professional codes, is a move in the right direction. Codes of conduct, in-house rules and pressure from the authorities, official as well as non-official, all help to achieve a moral or ethical climate of opinion against this form of abuse. This may not discourage the determined insider, but it will make it more difficult for him to operate.[36] He will be engaging in an activity which his peers and those around him consider is unethical. He will need to be more cautious in who he confides in, and detection and investigation of his actions will be made easier and cheaper. The insider has been put outside the 'security' of his own environment he is at risk. Of course, peer pressure is not only an aid to detection and enforcement, but has a normative effect in itself. Furthermore, devices designed to draw attention to unethical conduct, are also much more likely to have effect if the conduct in question is considered wrong by society or at least, by that section of society upon whom the subject needs to rely or within which he operates.

There is not only a need to educate those sections of the community which are likely to be in a position to misuse inside information. It is also most important that those responsible for regulation and administration of the law are also sufficiently aware of the implications of this form of abuse. In those few cases that have come before the courts in Commonwealth countries,[37] in most there has been an evident lack of appreciation by the court of the seriousness of the offence. In the cases that have come before the English courts the persons convicted have either not been deprived of their full profit or have received a punishment which, would seem to many, merely a slap on the wrist.[38] It is hardly surprising that police officers and others involved in combating crime give little attention to these cases, when the courts appear in some instances to regard the matter as much in the same as a 'parking offence'.[39]

2) In House Regulation

Placing an obligation on companies and financial intermediatires to 'supervise' the activities of their officers and employees in regard to dealings in certain securities is an effective inhibition to insider dealing.

In-house regulation is not only educative and self-disciplining in itself, but also an efficient form of self-regulation. Companies and professional financial intermediaries are often particularly well placed to effectively supervise the dealings of their insiders. Indeed, they are also likely to be far more 'sensatised' to the significance of inside information than outside regulatory authorities. In-house procedures differ greatly in scope and strictness.[40] Some compliance procedures are incorporated into contracts of employment and thus, achieve legal significance, others are operated more as codes of conduct. The resources devoted to in-house compliance also differ significantly. In certain more developed jurisdictions considerable reliance is now placed upon in-house compliance to not only prevent insider dealing, but also provide a more or less efficient detection device when it occurs. It is not without interest that many of the more significant cases of insider abuse in the United States and Britain, in recent months, have been 'detected' by internal compliance procedures. The records generated by these in-house rules have also materially assisted investigators in reconstructing dealing and timing transactions.

In the United States in-house procedures have long been as a front-line defence against insider abuse. In addition, to most self-regulatory authorities insisting upon often quite sophisticated clearance, vetting and restricted dealing procedures the Securities and Exchange Commission has on a number of occasions stipulated the establishment and effective operation of such procedures as a condition of settlement in enforcement and injunctive proceedings against companies alleged to be in violation of the anti-fraud provisions, Indeed, some American courts have almost gone as far, at the behest of the Commission, to place an affirmative legal duty on brokers and other financial intermediaries to ensure proper compliance with these procedures. There have been attempts to impose 'aider and abettor' liability on houses that have wilfully failed in this 'duty' to supervise those for whom they are responsible. Of course,.the securities industry is reluctant to assume this policy role, otherwise than as a responsibility of good citizenship. Legal compulsion is considered too draconian. However, should there not be such a duty cast upon those who offer investment services to the public - on a professional basis? Some have argued that such a duty could be based on the 'shingle theory' irrespective of any statutory or disciplinary rule. There are compelling enforcement policy reasons why an enforceable obligation should be placed upon those who are clearly 'responsible' for the activities of their officers and employees, to ensure due compliance with such procedures.

In Britain the Financial Services Act 1986,[41] casts a statutory obligation on 'authorised' persons to ensure that their authorised representatives comply with the various rules applicable to authorised persons, through in-house procedures

and contract law. Furthermore, in granting authorisation of an investment business, the Securities and Investments Board is bound to consider what arrangements the applicant has for internal supervision. A similar duty is cast upon recognised self-regulatory organisations in regard to their members. Although, it would seem that disciplinary sanctions are available against both the investment business and individual concerned, where such procedures are violated, unless the breach gives rise to liability under some other head, there is no direct civil or criminal liability for failing to supervise compliance. In the present author's view such a duty, even if benevolently enforced, would be salutary. The professional investment intermediary is fixed within jurisdiction and inevitably makes a 'soft' and probably co-operative target! In insider dealing cases - especially the more serious and complex ones, such co-operation is critical.

3) Aider and Abettor Liability

In the present author's view there is a strong case for casting a duty on professional intermediaries to satisfy themselves, so far as is reasonable - and in-house procedures may provide presumptive standards, that a client for whom they are acting is not violating an anti-insider trading law, or for that matter any other anti-fraud provision. Ironically, such a duty was cast upon licensed brokers, under a variety of statutory provisions during the Eighteenth Century in London. Similar duties have also been imposed under fiscal legislation, especially exchange control regulation, more recently. We already have an embryo requirement to 'know your client' under the developing obligations of suitability of investment advice. Of course, in exceptional cases 'aider and abettor' liability has been imposed on those who have deliberately facilitated fraudulent transactions. However, what is proposed here is an obligation cast, in positive terms, to assure the integrity of a transaction that they professionally facilitate, so far as is reasonable. Whilst some may consider that this would impose an intolerable burden on financial intermediaries it would be for those responsible for setting the standard of inquiry to determine what burden may reasonably be imposed. To expect those who have been accorded a privilege or licence to practise their profession in the securities industry, to assure themselves that they are not being used to perpetrate a fraud or abuse, is not in the present author's view excessive.

Timely Disclosure

We have already seen that in the case of reasonably efficient securities markets, the only way in which an investor can reasonably expect to obtain better than average investment returns is through exploiting whatever inefficiencies exist in the relevant market. In particular if he can exploit secret or inside information, he will probably be in an advantageous position vis-a-vis the rest of the market. Consequently,

reducing the quantity of secret or inside information that exists, at any given point in time, should logically reduce the scope for insider trading.[42]

The disclosure by corporate issuers of information relating to material corporate developments has long been an obligation imposed on companies with securities traded on organised stock markets. Timely disclosure, has been recognised as being more effective than continuous corporate reporting procedures, as it is both more immediate and in so far as its medium is not traditional financial statements, it is more intelligible. There are few systems of securities regulation that have followed logic to its conclusion and imposed an affirmative legal duty on issuers to make timely disclosure. There are, of course, many legitimate circumstances where it would be appropriate for an issuer not to publicly disclose a sensitive corporate development. It might be too premature,.it could mislead investors and there may be sound commercial reasons for secrecy. Nonetheless, an obligation on such an issuer, which could be equally discharged by notifying the relevant market authority of the event and the reasons for non-disclosure to the public - would, at least, alert the custodians of the market to the risks of insider and other abuse in connection with those securities. This expedient has been adopted by those jurisdictions which have imposed a statutory duty of timely disclosure on public issuers.[43]

Whilst a mandatory timely disclosure rule is not a panacea, and other anti-fraud devices must be held in readiness, it must be easier and cheaper to prove that a material corporate event, which would otherwise constitute an item of inside information, has occurred and that the board has failed to disclose this in the prescribed manner, or failed to justify non-disclosure to the authority responsible, than the traditional ingredients of an insider trading charge.[44] If, as we have seen, one of the reasons outlawing insider dealing is the desire to prevent those in a privileged position taking 'unfair' advantage of informational imbalances and inefficiencies in the market, does it not make more sense to strike, at least, to some extent, against those very information imbalances.

Whilst few would question the logic of this, many would argue that the present self-regulatory requirements in most jurisdictions are adequate and give a useful degree of flexibility. Unfortunately, in many cases this requirement has not worked well as a self-regulatory device.[45] It is in the extreme case, where corporate insiders are not co-operative, that a legal timely disclosure rule is most opportune. Insiders who are prepared to comply with the 'spirit and letter' of a self-regulatory rule are not in most cases likely to engage in insider dealing or manipulation. Experience in Britain, Canada and Australia, and to some degree in the United

States, has shown that in some cases insiders have been able to evade solely self-regulatory requirements by asserting the information in question is uncertain and, thus, compliance with the requirements of the stock exchange might expose them to civil liability on the part of those who have relied upon the disclosure, or that the information in issue was confidential. In other cases, self-regulatory authorities have been placed in the embarrassing position of being informed that an obligation to comply with a timely disclosure policy is superseded by compliance with some other self-regulatory rule. In not a few cases, insiders have simply ignored the obligation with impunity. In such cases what is the appropriate sanction? A few years ago a special committee of The Stock Exchange, in Britain, criticised the Quotations Department, of The Exchange, for taking the view that the obligation was not violated, simply because the market was illinformed as to certain impending significant market transactions.[46]

Then, the timely disclosure obligation only bit when a 'false market' existed in the relevant shares. A false market was not, then, in the Exchange's view an illinformed market. Certainly, the statutory provisions now in force in Canada and certain other Commonwealth jurisdictions would substantially resolve these problems.[47]

Reporting of Transactions

It has been suggested that transactions executed for insiders should be specially marked or, at least, recorded. Of course, most systems of company law provide for the recording of transactions by directors, their spouses and infant children and certain associates, in the securities of their issuer and related companies. Many laws also provide for these to be reported also to the stock exchange, where the securities are quoted on the exchange, or otherwise disclosed to the public. Indeed, for many years it was the view in Britain that this would in itself, impose a sufficient constraint on directors not to abuse their position. Sadly, it became apparent that the statutory provisions were not sufficiently effective against determined insiders who simply ignored them or utilized nominees. Furthermore, it is probable that in quantative terms most insider dealing does not involve directors - but others who have far less to lose if they happen to be caught. Of course, special reporting and disclosure devices can come into operation at certain times, such as in a take-over or merger transaction, and reporting can be extended and made more effective through various in-house rules and procedures.

How effective statutory reporting requirements are in assisting in the enforcement of substantive anti-insider trading provisions remains to be seen. There are, of course, statutory devices such as sections 16(a) and 16(b) of the United States Securities and Exchange Act 1934, where the substantive rule against insider short-swing trading depends

for its practical effect on a reporting obligation. Nonetheless, it would appear to be the case that serious insider abuse is not substantially impeded by traditional corporate reporting and other devices which are generally not enforced and in any case usually have derisory penalties. In the author's view there is advantage in such reporting obligations, which should extend further than directors of companies, to other categories of likely insider, such as financial intermediaries. The need to evade such an obligation, places another burden on the insider, it makes it slightly more risky and, if he has to use a nominee or a confederate, more expensive. Furthermore, it gives rise to an easily proven offence within jurisdiction. The insider is forced to enter the world of the criminal law with all that this entails at an initial stage in his illicit enterprise.

Sadly, enforcement and regulatory authorities invariably give far too little attention to what are often considered 'technical' or reporting offences. Whilst it is true, that a young prosecutor or investigator is unlikely to make a reputation in prosecuting or pursuing such offences, it is also the case that invariably one of the first signs that a criminal enterprise is taking place is a late or misfiling of a corporate document. Proper emphasis on the policing and monitoring of these disclosure devices, especially if linked to market surveillance, can have a significant preventive role.[48] Consequently, it is desirable to provide sufficient resources to enforce these provisions with speed and enthusiasm. Furthermore, officials and judges need to be 'educated' as to their potential significance in the fight against these abuses. It is far easier to secure a conviction against a director for failing to report his transactions in his company's shares than for insider dealing or market manipulation - and in practice the penalties likely to be imposed are not too different.[49]

Stock Watch Programmes

Lawyers, and for that matter policemen, tend to concentrate on the problems of investigating and prosecuting cases of insider abuse, without giving much attention to detection.[50] If it is not possible to efficiently detect cases of insider dealing, then the question inevitably arises, whether it is worth the time and cost of seeking to regulate it through the traditional process of investigation and trial.[51] Whilst most developed stock exchanges have operated various stock watch procedures for some time,[52] it would appear to be the case that a disturbingly high proportion of cases come to light not because of detection, in the proper sense of that word, but because someone has 'blown the whistle'. It would also appear that this person in many instances, especially in North America and Britain, has done this for a personal or professional grievance rather than for some more laudable motive. Of course, one of the problems in this form of

economic crime is that there is no real victim, except the market itself, in most cases of insider dealing.

Whilst it is perfectly feasible to erect a system of enforcement based on informants rather than complainants - such as is being devised increasingly in regard to money laundering cases, this has certain consequences. Informant orientated enforcement does not sit well with traditional concepts of fraud victimology. Of course, if we do accept the view propounded at the outset of this paper that insider dealing is really a 'fraud' or abuse against the market, and not as such against any specific component within the market, then this conceptual criticism is reduced. A more serious problem, however, is in ensuring that an informant orientated system of detection is sufficiently reliable and efficient. How can informants be developed, rewarded and deployed? Perhaps, one answer would be to cast affirmative duties on professional financial intermediaries to report suspicious transactions, as is now being suggested in the case of auditors.[53] Another device might be to provide a system of financial rewards, as has been suggested in the case of many laundering cases. Education has a role to play and the more insider dealing is considered unethical the more likely it will be that persons are prepared to inform. Effective and efficient in-house procedures and monitoring of insider's transactions also have important implications for detection.

Stock market surveillance, as operated on the more developed stock exchanges, is capable of identifying a number of unusual transactions, which can then provide a basis for further investigation. No matter how sophisticated these procedures are, and irrespective of the computer assistance available, the dedicated insider will be able to structure his dealing in such a way as to either avoid triggering the stock watch programme, or by using foreign nominees evade any investigations subsequent to detection. Again it is the casual and small time insider who is most likely to get caught. Consequently, again we have to ask whether the exercise is worth it?

By developing an integrated stock watch programme, as is operated by the New York Stock Exchange, the chances of catching the 'big fish' are significantly greater. The New York Stock Exchange's Automatic Search and Match System (ASAM) stores publicly available data on over half a million corporate executives, and over 75,000 companies. It is able to link executives through what clubs they belong to and where they bank, and who they consult. Perhaps rather too much like 'Big Brother' for many less 'sophisticated' markets this system has achieved some notable successes since it was introduced in 1985. Of course, in smaller jurisdictions a similar result may be achieved through using traditional intelligence procedures and developing integrated information and data cases. Information available from applications for licences, listing

and a host of other sources may be integrated and refined into an intelligence facility which is capable of not only reactive market surveillance, but pro-active vetting and monitoring. The system of control and supervision imposed on the securities industry needs to be attuned to these requirements to secure the greatest efficiency and accuracy.

Investigation

Whatever the nature of the norms against insider dealing, to achieve deterrence, enforcement, in whatever form chosen, must be predictable.[54] Unenforceable rules are of little value, save possibly from an educative standpoint and even this is debatable.[55]

Perhaps one of the most serious problems facing those seeking to prevent or regulate insider dealing is the profound problems of investigation. Sadly, the serious difficulties presented by the nature of the act tend only too often to be exacerbated by lack of expertise and deficient resources, compounded by lack of appreciation, on the part of the investigator. The experience gained by the City Panel on Take-overs and Mergers during the 1970s in Britain in policing its self-regulatory rule against insider dealing is instructive, as in the author's view the Panel Executive achieved a degree of professionalism in the conduct of its inquiries hitherto unrivalled in a common law jurisdiction.[56] The Panel's 'investigators', who were senior members of its Executive, without any formal, let alone legal, powers of investigation identified clear violations of Rule 34, the Code's anti-insider trading provision, in a significant number of cases. However, virtually all these cases involved 'minows' - 'small fry' who were either unable to go to any lengths to obscure their acts, or who were unaware of the risks. The more serious, in terms of amount and status, were unable to frustrate the Panel by using nominees, offshore banks, financial intermediaries and lawyers in foreign - especially 'bank secrecy' and 'haven' jurisdictions. The Panel on several occasions simply admitted that it had a fair idea of what had occurred, but had come up against the 'reticence' of a Swiss bank. The Insider Dealing Tribunal in Hong Kong, in a different environment and wielding very different powers, has faired little better. The North American authorities with all their 'bluff and bluster' have also made little impact on the serious and organised offenders. It is so easy in most jurisdictions to structure securities transactions in such a way as to involve multiple jurisdictions and to deal through persons, real or 'fictitious' beyond the reach of the relevant authorities. Indeed, the internationalisation of the world's main markets, both in terms of securities and players, along with mobility of capital, ease of communications and 'follow the sun' trading have exacerbated the problems faced by national regulatory authorities.[57] Unfortunately, the situation, already bad enough, has been aggravated by

unscrupulous individuals, who as lawyers, bankers and financial intermediaries have gone into business simply to provide anonymity and advice to those who wish to engage in dubious financial transactions. The insider who wishes to 'cash in' on his privileged information, with little effort and for a fee, can be assured of anonymity in both his dealings and in the enjoyment of his illgotten gains. If the financial community is unable or unwilling to tackle the 'mafia' fund launderer who perpetuates illicit trafficking in drugs and serious organised crime, how much sleep is likely to be lost over insider dealing, which is not even an offence in many jurisdictions?

Given the political imperative and support there are, of course, a number of things that can be done to, at least, give the 'crooks a run for their money'. It must always be remembered that the more expensive insider dealing is made the fewer will consider it economically worthwhile. The obligation on financial intermediaries to keep and maintain comprehensive research of transactions that they enter into, with proper and effective policing, of these requirements, is vital. Add to this an 'ethic' or preferably a 'liability' as such to assure themselves of the integrity, or at least, the identity of their principal and a substantial step is taken in the right direction. The financial intermediary who executes the relevant transaction is committed to the local market and is therefore a 'soft' target when it comes to an investigation. He must be 'encouraged' and if necessary protected, through a legal requirement, to know as much about the principal acceptable. Of course, he might only be aware of the next link in a chain of nominees, but this is, at least, some help and the obligations to know the ultimate identify of the principal should not be easily evaded. In this context the new provisions in the British Financial Services Act 1986 are interesting.

Under section 177(1) of the Financial Services Act, if it appears to the Secretary of State that there are circumstances suggesting there have been violations of sections 1, 2, 4 or 5 of the Insider Dealing Act, he may appoint one or more inspectors to carry out 'such investigations as are requisite to establish whether or not any such contravention has occurred' and to report the results to him.

If the inspectors consider that any person is or may be able to give information concerning any such offence they may require that person to produce any documents in his possession or control relating to the issue of the relevant securities or its securities, to attend before them and to give them all other assistance which 'he is reasonably able to give' in regard to the investigation. Inspectors may administer oaths and examine any such person under oath. A statement made by a person in compliance with a request made under this section can be used in evidence against him. Under section 177 (7) it is expressly provided that information that is subject to legal

professional privilege cannot be demanded by the inspectors. Furthermore, under section 177(8) banks need not disclose information ,relating to the affairs of a customer' unless the inspectors have reasons to believe that the customer 'may be able to give information concerning a suspected contravention' and unless the Secretary of State is satisfied that disclosure or production of documents is necessary for the purposes of the investigation. It remains to be seen how often inspectors will seek to utilise this power, and how willing the Department of Trade and Industry will be to sanction it. What is important is that this provision does give inspectors a wide power to require details concerning bank customers' affairs even when that person is not himself suspected of committing an offence. To what extent inspectors will be allowed to 'fish' remains an open question.

Section 178(2) of the Financial Services Act imposes penalties in case of failure to comply with a request for assistance or for information by an inspector. Where there is a refusal to co-operate the inspectors are empowered to certify this to the court and the court is empowered to inquire into the matter. If, after hearing evidence from both parties, the court is of the opinion that the refusal to co-operate is unreasonable, it may punish the person concerned as if he stood guilty of contempt. In the first case to come before the court on this section, Hoffmann J held that on the facts, it was not unreasonable for a journalist to refuse to disclose his source for two articles when requested to do so by inspectors appointed to inquire into suspected 'leaks' from a government department. The court considered that to over-ride the public interest in protecting journalists' sources it had to be shown that the information in question was necessary for discovering a specific wrongdoer. In the present case the information at most would assist as piece of a jigsaw. It was not the only thing standing in the way of the detection or prevention of a specific crime. Hoffman J made it clear, however, that had this other public interest existed, he would have held the journalist in contempt. The court may also direct that the Secretary of State can exercise his powers under section 178. Section 178(2) also provides, most importantly, that the court may so direct, notwithstanding that the offender is not within the jurisdiction, if the court is satisfied that he was notified of his right to appear before the court and of the powers available under this section.

When the court does direct that the Secretary of State may exercise his powers under section 178(3) in respect of an authorised person, he is empowered, by service of notice to cancel any authorisation after the expiry of a specified period. He may also disqualify him from becoming authorised to carry on investment business after the expiry of a specified period. Restrictions may also be imposed on any authorisation in respect of investment business during that specified period to the performance of contracts entered into before the notice

comes into force. The Secretary of State may also prohibit him from entering into transactions of a specified kind, or entering into them except in specified circumstances, or to a specified extent. Furthermore, he may be prohibited from soliciting business from persons of a specified kind, or otherwise than from such persons, or from carrying on business in a specified kind, or otherwise than in a specified manner. The period specified in the Secretary of State's notice must be such as appears to the Secretary of State reasonable to enable the person concerned to complete the performance of the contracts in question and to terminate such of them as are of a continuing nature before the notice comes into force.

When the court gives a direction under section 178(2)(b) in regard to a person who is unauthorised, the Secretary of State is empowered under section 178(5) to direct that any authorised person who knowingly transacts investment business of a specified kind, or in specified circumstances, or to a specified extent, with or on behalf of that unauthorised person shall be treated as being in breach of the rules made under Chapter V or Part I of the Financial Services Act relating to the conduct of business or, in the case of a person who is authorised by virtue of his membership of a recognised self-regulatory organisation or recognised professional body, the rules of that authority.

The Secretary of State may revoke a notice at any time if it appears to him that the person concerned has agreed to comply with the request in question. Revocation of such a notice does not revive authorisation, except where, apart from the effect of the notice the person concerned would be authorised by virtue of his membership of a recognised self-regulatory body. Of course, after revocation the person concerned can apply for re-authorisation. An obligation is placed on the Secretary of State to service copies of his notices on the designated agency and other self-regulatory authorities where the person concerned falls under their jurisdiction, or did before service of his notice.

Section 178(6) of the Financial Services Act provides that person who is asked to provide information or furnish a document shall not be taken to have a reasonable excuse for refusing to co-operate where the suspected offence relates to dealing by him on the instructions of, or for the account of, another person simply because at the time of his refusal he did not know the identify of that other person; nor is it a reasonable excuse that he was subject to the law of another jurisdiction prohibiting him from disclosing information relating to that transaction without the consent of that other person if he might have obtained that consent or obtained exemption from the law. It should be noted, of course, that the agent need not know the ultimate customer or beneficiary. In practice, it is common to use foreign banks or other intermediaries and the implicit obligation in this section to

'know your client' is discharged by simply disclosing who instructed the transaction. Where this person is overseas it is going to be as difficult as it always has been for the investigator to determine whether the information with which he has been provided is accurate and exactly what is the status of that other person.

It has also been a convenient excuse for financial intermediaries simply to assert against a request for information concerning a party in another jurisdiction that the laws of that country or territory prohibit the disclosure of such information. Invariably the laws of that other jurisdiction are not as restrictive as they are assumed to be. The cost and practical difficulties involved in attempting to force the issue, however, often persuade the investigator to abandon that line of inquiry. Section 176(6)(b) is a most useful device. It would seem from the wording of this provision, which is not entirely unambiguous, that such an agent will now have to show that he actually attempted to secure authority, according to the relevant foreign law, for the disclosure of the information or documents in question before he can be credited with a justified excuse for not co-operating with the inspectors. This may well encourage financial intermediaries to obtain from overseas clients advance authority to disclose relevant information to such an inquiry, as is now the practice in Switzerland and certain other jurisdictions.

Since these provisions were brought into effect on 15 November 1986, the Government has made a number of appointments of inspectors. Whether the considerable cost involved is justifiable, except in the face of a series of sensational scandals involving insider dealing, remains to be seen. In the author's view, the provisions are obviously useful but should be available without the need of a formal inspection. It is desirable to retain such powers in a standing basis within an authority where continuity of expertise and experience can be built up. The inspection process as traditionally administered is expensive, time consuming and its utility varies with the calibre of the inspector. In most cases it is a sledge-hammer and an expensive one at that. Smaller jurisdictions could not afford this luxury!

SUBSTANTIVE INHIBITIONS ON INSIDER DEALING

The various devices that have been discussed serve to impede and hamper insider dealing. They do not seek to attack it directly or substantively. Given the difficulties of determining a viable victim, when the trading takes place on a stock exchange, where the transactions are usually indirect and impersonal, whether a civil or criminal law prohibition is imposed upon this alone is more sensibly resolved by considerations of enforceability than concepts such as compensation and restitution. Where there is no clear victim,

in a personal sense, the concepts of compensation and restitution become theoretical. The victim is really the market and, thus, given the essentially public nature of the 'wrong' either civil or criminal penalties are justified. Before exploring the nature of such devices, it may be useful to examine in depth the provisions of the Company Securities (Insider Dealing) Act 1985 in Britain. It is one of the most recent and comprehensive sets of substantive prohibitions in force and has, despite certain weaknesses, achieved a degree of effectiveness.[58]

1) The Company Securities (Insider Dealing) Act 1985

Within this there are 12 separate offences. Given the relevance of a number of common concepts, the main constituents of the crime will be examined in relation to the basic offence of primary insider dealing.

The 12 offences in the 1985 Act are:

(1) primary insider dealing in the securities of the insider's own company (section 1(1));

(2) primary insider dealing in the securities of a company with which the insider's company has or is about to enter into a transaction with (section 1(2));

(3) secondary insider dealing in the securities of the informant's company (section 1(3));

(4) secondary insider dealing in the securities of a company with which his informant's company has or is about to enter into a transaction with (section 1(4));

(5) dealing in a capacity other than as an offeror (section 1(5));

(6) secondary insider dealing by other than the offeror (section 1(6));

(7) counselling or procuring a person to engage in insider dealing (section 1(7));

(8) communicating inside information for the purpose of insider dealing (section 1(8));

(9) primary insider dealing by a Public Servant (section 2(3)(a));

(10) secondary insider dealing on the basis of inside information obtained through a Public Servant (section 2(3)(b));

(11) counselling or procuring a person to deal on the basis of inside information obtained as or through a Public Servant (section 2(3)(c));

(12) communicating inside information obtained as or through a Public Servant for the purpose of insider dealing (section 2(3)(c)).

2) Primary insider dealing in the securities of the Insider's Own Company

The basic prohibition on insider dealing is contained in section 1(1) of the Insider Dealing Act. Subject to the defences in section 3, any individual who is, or at any time in the preceding six months has been, knowingly connected with a company shall not deal on a recognised stock exchange of that company if he is in possession of inside information. For the purpose of the Act, inside information is information which he holds by virtue of being connected with that company, which he knows is unpublished price-sensitive information in relation to those securities, and which it would be reasonable to expect a person so connected not to disclose except for the proper performance of the functions attaching to that position. If such an individual deals in the relevant securities while in possession of this information he commits an offence. It is not necessary for the prosecution to prove that he 'used' the information in arriving at his decision to deal; this is rebuttably presumed from his dealing while knowingly in possession of privileged information.

Only an individual can commit an offence under section 1(1) of the Insider Dealing Act. Given the emphasis that the offences place upon the dishonest state of mind of the trader, it was thought needlessly complex to impute an individual's state of mind to a company. However, in appropriate circumstances, the individuals responsible for a company engaging in insider dealing would themselves be liable as primary insiders under section 1(1), or for counselling and procuring or, where the inside information is passed on, for 'tipping'. Furthermore, there would be no objection to a company being regarded as an aider and abettor.

The individual must be knowingly connected with the company that has issued or made available the relevant securities, or have been knowingly connected with that company at any time in the preceding six months. He must appreciate that he is an insider of the issuer.

If the other elements of the offence are present, it matters not that the issuer with which the individual is connected is a foreign company. Section 11(a) of the Insider Dealing Act defines the word 'company' as meaning any company, whether a company within the meaning of the Companies Act 1985 or not. For liability as a primary insider under section 1(1)

of the Insider Dealing Act it is necessary to show that the individual is or was 'connected' with the corporate issuer. The relationships which gave rise to this mandatory relationship are exhaustively set out in section 9.

Directors of the company that issued or made available the securities, or of a related company are the only individuals who will automatically be connected with the company. It should be noted that, unlike the position in other jurisdictions, executive and non-executive directors are treated alike.

A related company is defined as, in relation to a company, any body corporate which is that company's subsidiary or holding company, or a subsidiary of that company's holding company section 11 of the Insider Dealing Act.

Officers, other than directors or employees of the company or a related company, will also be regarded as being connected with that company, but only where that individual occupies a position that reasonably may be expected to give him access to unpublished price-sensitive information in relation to the relevant securities, which it would be reasonable to expect a person in his position not to disclose except for the proper performance of his duties. The term 'officer', by virtue of section 16(2) of the Insider Dealing Act, will have the same meaning as under the 1985 Companies Act and therefore includes the secretary and managers, in addition to the directors. It might also include the company's auditor.

Any individual is also regarded as a connected person if he is in a position which involves a professional or business relationship between himself, his employer or a company of which he is a director and the issuer of the securities or a related company which, in either case, may reasonably be expected to give him access to unpublished price-sensitive information in relation to the securities of either company and which it would be reasonable to expect a person in his position not to disclose except for the proper performance of his duties.

From the wording of section 9(b) of the Insider Dealing Act it is not enough for the prosecution to establish that a particular officer or employee, who is not a director, was definitely in possession of inside information relating to the securities of his company when he dealt. To be a primary insider the officer or employee must be in a position which could reasonably be expected to give him access to confidential price-sensitive information concerning the securities of the company. If a particular officer or employee is not in such a relationship with the company he cannot be guilty of an offence under section 1(1) even though in a particular instance he might have come into possession of inside information. It would seem that the relationship must also be such that it is proper for the individual to have access to the information.

Of course, there are adequate sanctions outside the criminal law to discourage abuse of confidential information and in appropriate circumstances it might be possible to regard such individuals as secondary insiders.

The Financial Services Act 1986 adds an additional subsection to section 13 of the Insider Dealing Act extending the definition of dealings in securities to dealings for differences. Section 13(1A) thus provides that a person, whether as principal or agent, who buys or sells or agrees to buy or sell investments within Schedule 1, para 9 of the Financial Services Act shall be regarded as if he were dealing in those securities. Paragraph 9 of schedule 1 refers to rights under a contract for differences or under any other contract the purpose or pretended purpose of which is to secure a profit or to avoid a loss by reference to fluctuations in the value or price of property of any description or in an index or other factor designated for that purpose in the contract. This definition does not apply, however, where the parties intend that the profit is to be obtained or the loss avoided by taking delivery of any property to which the contract relates.

The offence of insider dealing occurs where an individual deals in the relevant securities while he is in possession of inside information. For the purpose of the Act a person deals in securities if, whether as principal or agent, he buys or sells or agrees to buy or sell any securities. Apart from the case of dealings through or with an off-market dealer which are subject to regulation under section 4 of the Insider Dealing Act, no offence is committed if the dealing takes place otherwise than on a recognised stock exchange.

In schedule 16 of the Financial Services Act 1986 it is provided (as an amendment to the Insider Dealing Act) that a recognised stock exchange means The Stock Exchange and any other investment exchange which is declared by an order of the Secretary of State to be a recognised stock exchange for the purposes of the Insider Dealing Act. It is the view of the Department of Trade and Industry that dealings in the United Securities Market constitute dealings on a recognised stock exchange for the purposes of the Act. This is a sensible and highly acceptable proposition. Of course, prior to the enactment of the Financial Services Act, recognition was under section 15 of the Prevention of Fraud (Investments) Act 1958. The Financial Services Act also amends the definition of 'dealing' in section 13 of the Insider Dealing Act by removing reference to investment exchanges. The Insider Dealing Act previously provided that dealings on a recognised stock exchange will include dealings through an investment exchange. Under the latter Act an investment exchange was defined as an organisation offering an anomalous dealing facility to subscribers. Under the new regime this extension of the definition of 'dealing' is of course unnecessary.

The term 'securities' is defined in section 12(a) of the Insider Dealing Act to mean 'listed securities'. In the case of a company within the meaning of the Companies Act 1985 or a company registered under Part XXII, Chapter II of that Act (ie a company not formed under the companies legislation but which is authorised to register) or an unregistered company, the term would include any shares, any debentures, or any right to subscribe for, call for or make delivery of a share or debenture whether listed or not. In relation to a company, 'listed securities' means any securities of the company listed on a recognised stock exchange. The terms 'share' and ,debenture' have the same meaning in relation to companies which were not incorporated under the Companies Act 1985 as they have in relation to companies which were so incorporated. It is important to note that 'put' and 'call' options are included in the definition of the word 'securities' by the phrase 'or any any right to ..... call for or make delivery of a share or debenture'. Thus insider dealing in options will be a criminal offence under section 1(1) of the Insider Dealing Act. Section 323 of the Companies Act 1985 prohibits directors, their wives and also their infant children, from purchasing options in the quoted securities of their company or a related company. The Insider Dealing Act does not supersede this blanket restriction as the policy behind section 323 of the Companies Act 1985 was only in part to inhibit insider dealing on the basis of privileged information. It was thought desirable that directors should be discouraged from speculating in the securities of their company on the basis of short-term considerations. It is interesting that the Financial Services Act does not extent the scope of the anti-insider-dealing provisions to transactions in a unit trust's listed units.

Section 12(b) of the Insider Dealing Act provides that listed securities in relation to a company means any securities of the company listed on a recognised stock exchange. For the purposes of the Act, unless the context otherwise requires, company means any company whether a company within the meaning of the 1985 Companies Act or not. Therefore, from the definition of 'securities' in section 12(b),securities issued or made available by foreign companies would be within the scope of the offences relating to insider dealing provided the security in question was listed on a recognised stock exchange. Where the securities are not listed, then the issuer must be a company within the meaning of the Companies Act 1985, or a company registered under Part XXII, Chapter II of that Act or an unregistered company (see above). The Companies Act 1985 simply provides (in section 735(1)(a)) that, for the purposes of the Act, 'company' 'means a company formed and registered under this Act or an existing company'. Therefore, the securities issued or made available by a foreign company would appear to be outside the scope of the offences contained in the Act save where such are listed on a recognised stock exchange. In particular, bond issues by overseas companies are outside the Act even if they are marketed in England to professional

securities dealers (within the exemption from the 'prospectus' provisions of the Companies Act) if they are not listed in London, even though they may be listed on an overseas stock exchange. Seemingly, if the relevant foreign securities are listed it does not matter if the dealing occurred on or off The Stock Exchange, as listed securities are 'advertised securities' for the purpose of the off-market dealing provisions in section 13 of the Insider Dealing Act.

An offence under section 1(!) of the Insider Dealing Act is committed only where an individual deals while in possession of inside information. It is not necessary for the prosecution to establish that the inside information was used by the insider in arriving at his decision to deal. This arises by implications from the facts of possession and dealing. The individual must hold the information by virtue of being connected, or having been connected, with the relevant company. This means that the prosecution must show that the individual obtained inside information through his special access relationship with the company. The information must be such that it would be reasonable to expect a person so connected not to disclose except for the proper performance of the functions attaching to that position. The test here should be, simply, would that individual be in breach of his duty to the company if he disclosed the information in question?

It must be proved that the individual knew that the information was unpublished price-sensitive information in relation to the securities in which he deals. The Insider Dealing Act does not elaborate upon the phrase 'unpublished price-sensitive information' except to emphasise in section 10(b) that it must be specific and not generally known to those persons who are accustomed or would be likely to deal in those securities, but rather information which would if it were generally known to them be likely materially to affect the price of those securities. The more specific the information the less risk the insider takes by acting upon it.

Section 10(a) provides that the information must 'relate to specific matters relating or of concern (directly or indirectly) to that company, that is to say, is not of a general nature relating or of concern to that company'. The wording of this requirement is obscure. It is unclear whether it was the intention of the draftsman to limit the scope of the provision to matters which specifically related to a particular company, or to specific matters relating to that company. It is submitted that the better view is to regard the criteria of specificity as relating to the information.

The information must not be known by those persons who would be accustomed to dealing or likely to deal in the relevant securities. It is not enough for an insider to prove that the information was available on request if in fact it was not actually known. The test of materiality is relatively

strict, as the information must be such that if it were generally known to persons who are accustomed or would be likely to deal in those securities it would be likely to materially affect the price of those securities. It is not enough that the information would be likely to influence most investors in arriving at a decision whether to sell or buy the relevant security if it would not also be likely to materially affect the market price.

The offence of insider dealing requires proof that an individual in a privileged position, has deliberately abused his position to engage in insider dealing. Thus the prosecution must prove that the individual was intentional, or at least reckless, in relation to all the elements of the offence. The individual must know he is, or has been, connected with a company; he must know that information which he has obtained by virtue of that relationship is unpublished price-sensitive information in relation to the relevant securities; and then he must deal in those securities on a recognised stock exchange. The word 'knows' imports a subjective state of mind, and thus requires proof of intention or subjective appreciation of the relevant facts. It is probable that recklessness would be sufficient, although clearly constructive or imputed knowledge would not. The offence of insider trading under section 1(1) does not require that the individual knowingly dealt, and the question of wholly involuntary transactions is left unanswered.

3) Primary Insider Dealing in the securities of other companies

Section 1(2) of the Insider Dealing Act extends the basic offence of insider dealing in securities of the insider's own company to insider dealing in the securities of another company. Subject to the defences specifically provided in section 3 of the Act, an individual who is, or at any time in the preceding six months has been, knowingly connected with a company shall not deal on a recognised stock exchange in securities of any other company if he is in possession of inside information which relates to any transaction, actual or contemplated, involving his company and that other company, or involving one of them and the securities of the other, or to the fact that any such transaction is no longer contemplated. The inside information must be acquired by virtue of the individual's connection with the first-mentioned company, as in the case of section 1(1), and it must be such that it would not be reasonable to expect a person so connected and in the position by virtue of which he is connected not to disclose except for the proper performance of the functions attaching to that position. Of course, he must also know that it is unpublished price-sensitive information in relation to the securities of that other company.

The inside information must relate to a transaction which is either actual or contemplated, or to the fact that such a transaction is no longer contemplated. The transaction to which the inside information must relate may be a transaction involving both the insider's company and the issuer of the securities in which he is prohibited from dealing, or one of the two companies and the securities of the other. The meaning of the word 'transaction' is not entirely free from difficulty - would it be interpreted as requiring a commercial or bilateral element? Support for the view that the word transaction might have a unilateral connotation is found in the express inclusion of inside information concerning a transaction by one company in the securities of another. Thus the unpublished intention of the board of one company to acquire or dispose of securities in another company could constitute inside information.

An individual who is a director of a company related to the corporate issuer is automatically regarded as being connected with that issuer, and the same principle applies to other primary insiders such as officers, employees and persons in a professional or business relationship.

4) Secondary Insider Dealing

Secondary insider dealing or 'tippee' trading is outlawed by section 1(3) and (4) of the Insider Dealing Act. Under this provision it is necessary for the prosecution to establish that an individual came into possession of information which he knowingly obtained, directly or indirectly, from another individual who is connected with a particular company or who was so connected at any time during the six months preceding the obtaining of the information and who the tippee knows or has reasonable cause to believe held the information by virtue of being so connected. The tippee must also know or have reasonable cause to believe that because of his informant's connection and position it would be reasonable to expect him not to disclose the information except in the proper performance of the functions attaching to that position. If the tippee then deals on a recognised stock exchange in the securities of that company knowing that the information is unpublished price-sensitive information in relation to those securities then, subject to the defences provided in section 3, he commits an offence.

As in the case of a primary insider, he should not deal on a recognised stock exchange in the securities of any other company if he knows that the information is unpublished price-sensitive information in relation to that company's securities and that it relates to any transaction, actual or contemplated, which involves the company with which his informant is or was connected and the issuer of the relevant securities, or which involves one of them and the securities of the other, or which relates to the fact that any such

transaction is no longer contemplated. Much of what has already been said in relation to primary insider dealing applies to the offence provided for under section 1(3) and (4), and only points of special significance to secondary insider dealing will be raised here.

The secondary insider or tippee must knowingly obtain the inside information from an individual who is, or has been at any time during the preceding six months, connected to the issuer of the securities, or a company with which the issuer has entered or contemplates entering into a transaction. The informant - the primary insider - must have been connected, if not presently connected, with the company during the period of six months preceding the tippee obtaining the information from him, although in the case of primary insider dealing the dealing itself must take place within this period of six months. Here it matters not when the secondary insider decides to exploit the information.

The tippee must know or have reasonable cause to believe that his informant held the inside information by virtue of being connected with the company. Constructive knowledge would be sufficient. Thus it would be enough for the prosecution to establish that the tippee was aware of facts which would put a reasonable man on inquiry. The objective standard also applies to the question whether the tippee appreciated that because of his position it would be reasonable to expect him not to disclose the information save in proper performance of the functions attaching to that position. While the objective standard is in contrast to the requirement of subjective knowledge elsewhere in the Insider Dealing Act, it is not objectionable in the circumstances as it would be almost impossible to establish actual knowledge in either case.

The question whether the tippee's informant was aware that the secondary insider was obtaining from him unpublished price-sensitive information or not is irrelevant to the secondary insider's liability. A secondary insider commits an offence if he deals while in possession of inside information which he obtained directly or indirectly from a primary insider. Direct communication whether the informant has behaved properly or not, causes no real problem. However, it is uncertain how far the interpretation of 'indirectly' may be stretched. Before a prosecution is brought under section 1(3) and (4) careful attention will have to be given to the requirements of specificity and materiality in relation to the inside information. The more information changes hands, the more imprecise and unreliable it becomes. Second and even third or fourth tippees may be within the scope of the offence in so far as they acquire inside information from a primary insider 'indirectly' through a chain of tippees.

5) Take-overs

Although there is little empirical evidence, it is probable that most insider dealing takes place in relation to take-over operations and other substantial acquisitions. Hence a special provision on this has been included in the Insider Dealing Act. Subject to the defences in section 3, where an individual is contemplating, or has contemplated, making a take-over offer for a company in a particular capacity, whether with or without another person, it is an offence under section 1(5) for that individual to deal on a recognised stock exchange in the securities of that company in any other capacity if he knows that information that the offer is contemplated or is no longer contemplated is unpublished price-sensitive information in relation to those securities. Thus the effect of section 1(5) is simply to prohibit an individual contemplating a take-over for the securities of a particular company from dealing in those securities in any other capacity. 'Take-over offer' is defined in section 14 of the Insider Dealing Act to mean an offer made to all the holders, or all the holders other than the person making the offer and his nominees, of the shares in the company, or a class thereof, to acquire those shares or a specified proportion of them.

This provision, therefore, would render it an offence for an individual who is wholly unconnected with a company to deal in the securities of that company except for the purpose of a take-over which he contemplates making, either alone or with others.

Section 1(6) of the Insider Dealing Act extends the scope of section 1(5) to individuals who become aware of the intention of another to make a take-over offer for the securities of a company and are thus privy to inside information. Subject to the defences in section 3, where an individual has knowingly obtained, directly or indirectly, from an individual who is contemplating, or who has contemplated, making (whether with or without another person), a take-over offer for the securities of a company, information that such an offer is being contemplated or is no longer contemplated, then that individual commits an offence if he deals in the relevant securities on a recognised stock exchange. He must of course know that the information is unpublished price-sensitive information in relation to those securities. In practical terms the effect of both sections 1(5) and 1(6) will be to give Rules 2 and 4 of the City Code on Take-overs and Mergers the sanction of the criminal law. However, in relation to section 1(6) it should be emphasised that the individual prohibited from dealing must knowingly obtain the inside information directly or indirectly from the individual actually making or contemplating making the take-over offer. If he obtains this information from someone else who is not a primary insider of the relevant company, he commits no offence if he deals.

6) Counselling and Procuring

If there was no provision in the Insider Dealing Act outlawing counselling and procuring, the substansive prohibitions could be easily evaded. Thus, section 1(7) renders it an offence for any individual who is for the time being prohibited by any other provision of section 1 from dealing on a recognised stock exchange in any securities, to counsel or procure any other person to so deal, knowingly or having reasonable cause to believe that that person would deal in them on a recognised stock exchange or through an investment exchange. It is an offence under this subsection to counsel or procure a company to deal, as the provision refers to the counselling or procuring of 'any other person' rather than 'individual'.

It is not certain how widely a court would be prepared to interpret the words 'counsel and procure'. Instructing an agent to deal would be covered, but in such cases the principal would himself be regarded as dealing and thus it is unnecessary to resort to section 1(7.). Where an insider communicates inside information to another with the expectation that that other person will deal in the relevant securities, an offence is committed under section 1(8). In practice it is probable however, that many instances will arise where the insider has done less then communicate the information but nevertheless has counselled or procured the transaction. Thus this provision would cover the sort of recommendations and pointed hints which in practice are far more common than direct and obvious unauthorised communications. For an offence to be committed under this provision it would also be necessary to establish that the insider counselled or procured knowing or having reasonable cause to believe that that person would deal in the relevant securities on a recognised stock exchange.

7) 'Tipping'

Section 1(8) of the Insider Dealing Act provides that, subject to the defences in section 3, an individual who is for the time being prohibited by virtue of section 1 from dealing on a recognised stock exchange in any securities by reason of his having any information, must not communicate that information to any person if he knows, or has reasonable cause to believe, that that or some other person will make use of the information for the purpose of dealing, or of counselling or procuring any other person to deal, on a recognised stock exchange. This provision renders it an offence to communicate the relevant information 'to any other person' and thus would cover 'tipping' a company. For liability under this subsection the primary or secondary insider, who is himself prohibited from dealing, must communicate the specific inside information in question. The insider must also know, or have reasonable cause to believe, that the recipient or some other person will make use of the information for the purpose of dealing or

counselling or procuring another person to deal on a recognised stock exchange. As the standard of knowledge is objective, the prosecution need only establish that the insider had reasonable cause to believe that the recipient of the information or some other person would so make use of it. Whether the information is in fact used is irrelevant in relation to the liability of the insider.

8) The Defences

The Insider Dealing Act provides certain general and specific defences to charges of insider dealing. Section 3(1)(a) provides that section 1 shall not prohibit any individual by reason of his having any information from doing any particular thing otherwise than with a view to the making of a profit or the avoidance of a loss, whether for himself or another person, by the use of that information.

In practice it is hard to envisage circumstances where a deal would not be, at least in part, for the purpose of making a profit or avoiding a loss for oneself or another. Thus, unless the court is prepared to interpret this provision as meaning that the insider's primary object must be to make a profit or to avoid a loss, this defence would provide scant protection.

Liquidators, receivers and trustees in bankruptcy are placed outside the scope of the prohibition on insider dealing provided the deal is entered into in the course of the exercise in good faith of their functions. There are specific exemptions for both jobbers and market makers, who are in many ways the professional 'insiders' of the securities markets. A ,jobber' is defined in section 3(1)(c) to include an individual, partnership or company dealing in securities on a recognised stock exchange and recognised by the Council of The Stock Exchange as carrying on the business of a jobber. The Financial Services Act 1986 in section 174 adds a further subsection to section 3 of the Insider Dealing Act to deal with market makers. Section 174(2) defines a market maker as a person, whether individual, partnership or company, who holds himself out at all normal times in compliance with the rules of a recognised stock exchange as willing to buy and sell securities at a price specified by him, and is recognised as doing so by that recognised stock exchange. In the case of a jobber of the Insider Dealing Act, under section 3(1)(c) and a market maker, under the new section 3(1)(d), he will not be prevented from doing any particular thing if the unpublished price-sensitive information was obtained by him in the course of his business as a jobber or market maker and was of a description which it would be reasonable to expect him to obtain in the ordinary course of that business, and he does that thing in good faith in the course of that business. In other words, provided the jobber or market maker obtains the inside information in the course of his business, and the

information is of a kind that it would be reasonable and normal for a jobber or market maker to obtain in good faith in the conduct of his business, any dealing while in possession of that information will not violate any of the prohibitions contained in section 1.

Section 3(2)(a) of the Insider Dealing Act provides that an individual shall not by reason only of having information relating to any particular transaction be prohibited by sections 1(2), (4)(b), (5) or (6) from dealing on a recognised stock exchange in any securities if he does so in order to facilitate the completion or carrying out of the transaction. Section 1(2) and 1(4)(b) prohibit individuals connected with a company, or who obtain information from an individual connected with a company, from dealing in the securities of another company while in possession of unpublished price-sensitive information relating to a transaction involving both the first-mentioned company and that other company, or involving one of them and the securities of the other. Section 1(5) and 1(6) prohibit an individual contemplating making a take-over and persons privy to that intention from dealing in the securities of the potential offeree other than for the purpose of that offer. The effect of section 3(2)(a) is simply to allow the individual concerned with the particular transaction to deal in the relevant securities; although he is in possession of inside information, where that dealing is done in order to facilitate the completion or carrying out of that transaction. This provision is both necessary and desirable, although problems may arise in regard to the moment when the exemption comes into operation.

Section 3(2)(b) by the same token permits an individual within the scope of the prohibitions contained in sections 1(2),(4)(b) and (6) to counsel and procure other persons, or communicate the relevant information to others, provided that it is done in order to facilitate the completion or carrying out of the transaction.

There are many occasions when financial intermediaries come into possession of information, which may well be inside information, in circumstances where they might be under a 'duty' to use that information for the benefit of some other person. Subsequent to the 'Big Bang' the scope for such a dilemma is substantially increased. The conflict of ,duties, in which many 'multiple function fiduciaries' find themselves when in possession of unpublished price-sensitive information is only given partial attention by the Insider Dealing Act and is virtually ignored by the Financial Services Act.

A strict application of traditional fiduciary duties, where an agent owes duties to clients with possibly competing interests, could well impose an intolerable burden on such intermediaries as merchant banks, broker-dealers, fund managers and other professionals in the securities industry. Sadly, the

courts have shown themselves to be unenthusiastic in attempting to resolve these very practical issues. It is at least arguable that in certain circumstances a professional agent such as a merchant bank, could be regarded as being under a fiduciary, contractual and tortious duty to ensure that information that comes into its possession does not operate to the disadvantage of its clients. Indeed, the burden is greater than it was in so far as the Financial Services Act and the various rules made under its authority significantly strengthen the responsibility on professional advisers to ensure their advice and stewardship are both prudent and suitable to the circumstances of the client. The argument that there is a similar duty to ensure that the client's personal interests are best served and furthered by the use of such information to derive a profit rather than avoid a loss is convincing. Where the relevant information is not obtained in some other confidential relationship, then it is not easy to see what defence a merchant bank would have to the claim of an investment client that he is entitled to expect the utilisation of that information for the advancement of his interest.

Although it is always open to the professional adviser to avoid such claims through appropriate wording in the contract between it and the client, in practice this expedient has not been widely adopted. Where the relevant information is obtained in a confidential capacity, questions of priority arise between the professional adviser's clients. For example, supposing a merchant bank were in possession of unpublished price-sensitive information concerning the securities of one of its corporate clients, what would be the responsibility of the merchant bank to its investment clients and managed funds in relation to this information? There are no obvious answers. In practice the principle of segregation of function, and thus information, is widely adopted. The creation of so called 'Chinese Walls' between various and potentially conflicting functions has long been endorsed by the various self-regulatory authorities and was recognised in the former Licensed Dealers (Conduct of Business) Rules 1983. Nonetheless, there is no assurance that segration of function within a single entity would be accepted by a court as resolving a conflict. It is not without interest that the Government in its White Paper observed that it was 'not convinced that total reliance can be placed on Chinese Walls because they restrict flows of information and not the conflicts of interest themselves'.

Of course, the principle of segration has been recognised and adopted in the various draft rules of the new self-regulatory authorities, but still the legal position is tentative. While no court would accept that there is a duty to use inside information where such would constitute a criminal offence under the Insider Dealing Act, there are many situations where no violation of the criminal law would be involved.

Section 7 of the Insider Dealing Act addresses itself in part to these problems. Where a trustee or personal representative, or a body corporate or an individual acting on behalf of that trustee or a personal representative would be prohibited by virtue of section 1 from dealing or counselling or procuring any other person to deal in any securities, or counsels or procurs any other person to deal, he shall be presumed to have done so otherwise than with a view to the making of a profit or the avoidance of a loss, whether for himself or another person, by the use of that information. There is a rebuttable presumption that the dealing or counselling or procuring is unobjectionable under the Act. This presumption will only arise, however if the individual concerned acted on the advice of a person who appeared to him to be an appropriate person from whom to seek such advice and did not appear to him to be prohibited by section 1 from dealing in those securities.

9) Insider Dealing - Public Servants

The scope of the crime of insider dealing is extended to public servants by section 2 of the Insider Dealing Act. Previous to the Financial Services Act this provision had applied only to Crown servants. This term was defined in section 16 to mean an individual who holds office under, or is employed by, the Crown. This means that officials and employees of nationalised industries and local authorities were beyond the reach of these criminal provisions. Professor Gower criticised this in his report and consequently the Financial Services Act amended section 2 to widen the scope of the offences. Section 173 of the Financial Services Act amends section 2 of the Insider Dealing Act to provide that public servants include, in addition to Crown servants, any person declared by order of the Secretary of State to be a public servant. Under a new subsection (5) to section 2, if it appears to the Secretary of State that the members, officers or employees of, or persons otherwise connected with, anybody appearing to him to exercise public functions, may have access to unpublished price-sensitive information relating to securities, he may by statutory instrument declare that they are public servants for the purpose of section 2. Furthermore, it is also provided that a member, officer or servant of a designated agency, competent authority, transferee body, recognised self-regulatory organisation will be a public servant for this purpose. This is most significant extension of the anti-insider-dealing provisions, but one which is wholly justified.

For the purposes of section 2 of the Insider Dealing Act, inside information is defined as information that is held by a public servant or former public servant by virtue of his position, or former position, as a public servant, or is knowingly obtained by an individual, directly or indirectly, from a public servant or former public servant who he knows or

has reasonable cause to believe held that information by virtue of any such position. Furthermore, the information must be such that it would be reasonable to expect an individual in the position of the public servant, or former position of a former public servant, not to disclose except for the proper performance of the functions attaching to that position, and it must also be shown that the individual holding it knows that it is unpublished price-sensitive information in relation to the securities of a particular company. The section covers public servants and former public servants who are in possession of inside information by virtue of their office or former office and any individual who knowingly obtains that information, directly or indirectly, from such a person knowing, or having reasonable cause to believe, that he held the information by virtue of his position or former position as a public servant.

An individual to whom section 2 applies will be guilty of an offence if he deals in the relevant securities on a recognised stock exchange, or counsels or procures another person to so deal, or communicates to any other person the information held or (as the case may be) obtained by him, if he knows or has reasonable cause to believe that that or some other person will make use of that information for the purpose of dealing, or of counselling or procuring any person to deal, in any such securities on a recognised stock exchange. The defences in section 3 are made expressly applicable to offences under section 2.

10) 'Off-market' Deals

Sections 1 and 2 of the Insider Dealing Act outlaw conduct in relation to inside information with regard to dealing on a recognised stock exchange. The prohibitions contained in those sections are extended by section 4(1) of the Act to transactions in 'advertised securities' taking place outside this market, subject to the special provisions in regard to international bonds, section 4(1)(a) provides that sections 1 and 2 apply in relation to dealings, other than on a recognised stock exchange, in the advertised securities of any company as they apply in relation to dealings in securities on such a stock exchange, if the dealing is through an off-market dealer who is making a market in those securities in the knowledge that he is an off-market dealer, that he is making a market in those securities and that the securities are advertised securities: or if the dealing is an off-market dealer who is making a market in those securities or as an officer, employee or agent of such a dealer acting in the course of the dealer's business. Therefore it will be an offence for an individual who would be prohibited from dealing on a recognised stock exchange by virtue of section 1(!) to deal in the relevant securities off the stock exchange if that dealing were through an off-market dealer who was making a market in those securities, and if he was aware of this and of the fact that the securities were advertised securities. He

would also commit an offence were he to deal as an off-market dealer acting in the course of his business, or as an officer, employee or agent of such acting in the course of the dealer's business.

Section 4(1)(b) extends the relevant provisions in sections 1(7) and 2(3)(b) to counselling or procuring a person to deal, as mentioned in section 4(1)(a), in advertised securities in the knowledge or with reasonable cause to believe that person would so deal. Section 4(1)(c) extends the offence of communicating inside information to another person knowing or having reasonable cause to believe that that person or some other person would use that information for the purpose of dealing as mentioned in section 4(1)(a). Thus these offences apply in relation to off-market deals within the meaning of section 4(1)(a) as they do to deals on a recognised stock exchange. What has already been said in relation to the provisions in sections 1 and 2 applies to the offences under section 4(1). Section 4(2), which is added by section 174 of the Financial Services Act, provides that in its application under section 4(1) the definition of 'market maker' in section 3(1) shall have effect as if the references to a recognised stock exchange were references to a recognised investment exchange within the meaning of the Financial Services Act. The effect of this rather clumsy clause is to extend to recognised investment exchanges the exemption of market makers acting both in the ordinary course of their business and in good faith. Without this provision a market maker on a recognised investment exchange would have been at a material disadvantage.

On a slightly different point, section 197 of the Financial Services Act provides that market makers, as defined in the latter Act will be entitled to the exemption previously enjoyed by jobbers of The Stock Exchange from the disclosure and reporting requirements of Part VI of the Companies Act 1985 in regard to substantial interests in a company's shares. This exemption will now extend therefore to market makers on investment exchanges other than the Stock Exchange but not to mere market dealers.

An off-market dealer means a person who is an authorised person within the meaning of the Financial Services Act. Such a person will be taken to make a market in any securities if in the course of his business as an off-market dealer he holds himself out, both to prospective buyers and to prospective sellers other than particular buyers and sellers, as willing to deal in them other than on a recognised stock exchange. He will be taken to deal in advertised securities if he deals in such securities or acts as an intermediary in connection with deals made by other persons in such securities, and an individual will be taken to deal through an off-market dealer if the latter is a party to the transaction, is an agent for either party to the transaction, or is acting as an intermediary in connection with the transaction.

Section 4 of the Insider Dealing Act only applies where the off-market dealing involves advertised securities. Section 12(c) of the Act provides that this means listed securities, or securities in respect of which information indicating the prices at which persons have dealt or.were willing to deal in those securities has been published, not more than six months before the alleged offence, for the purpose of facilitating deals in those securities.

Where securities which are listed on The Stock Exchange, or regularly traded off The Stock Exchange in the UK, are also dealt in on a foreign stock exchange, it would be relatively easy for a primary or secondary insider to evade the prohibitions contained in sections 1, 2 and 4 of the Insider Dealing Act by counselling or procuring a person to deal in those securities abroad or by communicating the inside information to another person with the expectation that he will so deal.

Consequently, section 5(1) provides that an individual who, by reason of his having any information, is for the time being prohibited by any provision of sections 1 and 2 from dealing in any securities, shall not counsel or procure any other person to deal in those securities in the knowledge or with reasonable cause to believe that that person would deal in the securities outside Great Britain on any stock exchange other than a recognised stock exchange, or would communicate that information to any other person in the knowledge or with reasonable cause to believe that or some other person will make use of the information for the purpose of dealing or counselling or procuring any other person to deal in the securities outside Great Britain on any stock exchange other than a recognised stock exchange. Thus it is a criminal offence for an insider in possession of unpublished price-sensitive information in relation to listed or advertised securities to counsel or procure another person to deal in those securities or communicate that information to another person in the expectation that that other person will deal in those securities on a foreign stock exchange.

Finally, it is provided in section 5(2) that section 5(1) will not prohibit an individual from acting as mentioned in any of paras (a)-(c) of section 3(1) by reason of his having any inside information. In other words, the defences provided in section 3 will be available where activity occurs outside Great Britain but within the scope of section 5(1).

11) International Bonds

The provisions in sections 4 and 5 of the Insider Dealing Act would by their terms subject dealing in international bonds on the euro-bond market to the strict anti-insider-dealing provisions in section 1. This was considered unnecessary and undesirable. This market is both

highly professional and, by definition, international. Those who trade on this market invariably act as both brokers and market makers and to impose the strict provisions of section 1 would substantially impede their operations. Consequently section 6 provided for two separate defences to charges of insider dealing for professional dealers in international bonds. The Financial Services Act has, however, substantially amended this section. The new section 6 of the Insider Dealing Act simply provides that the exemption is now restricted to an authorised person acting to stabilise the price of such bonds for a specified period following issue, in accordance with such rules as are made under section 48 of the Financial Services Act.

12) The penalties for insider dealing

Section 8 of the Insider Dealing Act provides that an individual convicted on indictment of an offence under any of the provisions in sections 1 and 2 of the Act will be liable to a term of imprisonment not exceeding two years and/or an unspecified fine. On summary conviction such an individual may be sentenced to a term of imprisonment not exceeding six months and/or a fine not exceeding the statutory maximum (of £2,000). Proceedings for an offence under the Act may not be instituted in England and Wales except by the Secretary of State, or by or with the consent of the Director of Public Prosecutions. In Scotland prosecutions would be brought by the relevant Procurator-fiscal.

It has been suggested that in appropriate cases a court, after conviction of an insider, might make a compensation order. It is doubtful, however, whether in practice a court of criminal law would be prepared to enter upon the kind of inquiry which would be necessary to justify both the quantum of compensation and who, if anyone, should be entitled to such compensation. It is also important to realise that 'Compensation Orders should not be used where there is any doubt as to the liability to compensate' and that an order can only be made in favour of an identified person. This would tend to confine compensation orders to direct personal transactions.

When insider dealing was first made a specific criminal offence there was considerable scepticism whether prosecutions would be brought and, if they were, whether there would be convictions. It was thought that it would only be in the most obvious and egregious cases that a prosecution would be at all likely. Insider dealing is extremely difficult to detect, and given the poor record in combating fraud generally it was reasonably assumed that few if any cases would end up in court. The record since 1980 has not been bad - at least by international standards. At the time of writing there have been seven prosecutions and five convictions. A number of other cases are pending. The Government has gone on record as

wishing to 'stamp out' this 'pernicious practice'. Although it is inevitable that only a very small proportion of cases is amenable to the criminal law process, the Government's determination is commendable.

13) Civil consequences

Section 8(3) of the Insider Dealing Act expressly provides that no transaction shall be void or voidable by reason only that it was entered into in contravention of sections 1 or 2. Such transactions may be attacked on some other ground. Now that insider dealing is a specific criminal offence the courts might be more willing to find a civil remedy, at least in relation to direct personal transactions. It should also be noted that the subsection does not necessarily prevent a court from allowing an action for damages to proceed on the basis of breach of statutory duty. Given the clear intention of Parliament not to provide an express civil remedy in such cases, and the almost insoluble questions of causation and determination of damages that would arise in other direct personal transactions, it is submitted that it would be most unlikely that a court would be prepared to find such a cause of action.

14) Civil Liability

Most jurisdictions that have sort to regulate insider dealing have provided some kind of civil liability either to the person with whom the insider happened to deal, or to the corporate issuer. This is not the place to discuss the question of civil liability generally, or to explore the various devices that have been created to discourage insiders' abusing their positions. The present author would rather raise the more specific issue whether it is appropriate to provide a special liability on the insider to account for his profit, in either a positive or negative sense, to the corporate issuer?

The present author is convinced that in most jurisdictions it would not be practicable to devote the amount of resources to combating insider trading that would be required to constitute a significant deterrent. Consequently, some means outside the criminal law and enforcement by public or official bodies must be contemplated. Already in Britain the Chairman of the Securities and Investments Board has stated that where appropriate he intends to initiate restitutionary and injunctive actions against insiders under Section 61 of the Financial Services Act.[59] Whilst such actions, as North American experience shows, have a considerable potential in curbing insider abuse, at the risk of appearing cynical the present author doubts whether the SIB will have the resources or, perhaps, ability to assume this role.

The author has proposed elsewhere,[60] the enactment of a statutory provision which would simply provide that a primary

or secondary insider, as defined in the Company Securities (Insider Dealing) Act 1985, would be liable to the company in whose securities the insider dealing occurred, for the full profit made or loss avoided according to a statutory formula. Preferably this liability should be for an amount in excess of this profit; a multiple of the actual profit. The insider would be accountable for this amount to the company which should be able to proceed as a debt. The insider would be liable for the company's costs and would be entitled to no set-off or allowance for expenses. In default of the company bringing this action within, say six months of the liability coming to light, then any shareholder would have a derivative right of action to enforce this liability on behalf of his company. It may be desirable to provide some incentive, beyond an assurance as to costs to such potential litigants. Alternatively, this derivative right may rest in such a body as the Securities and Investment Board in Britain or Securities Commission in New Zealand. It may be made an obligation for listed companies to enforce such actions through amendment of the Listing Agreement. Of course, this device does not resolve all the problems, but it does provide a powerful enforcement mechanism - which is limitless in its resources and directly interested. It can be justified not on irrelevant arguments of compensation or restitution, but as a cheap and probably more effective sanction against a serious threat to the market and, thus, all those who use it. In Britain, the Government have expressed considerable interest in such a provision and it is not unlikely that legislative proposals will materialise in the course of time. It is important to emphasise, however, that this proposed liability would not stand alone, but would with all the other devices alluded to, including the prospect of criminal liability, be held in the armoury against insider abuse.

CONCLUSIONS

The present writer has attempted, to canvass some of the more practical issues associated with regulating insider dealing. There are, of course, other points which have not been raised, such as the applicability or adoption of the existing civil law.[61] Inevitably the line must be drawn somewhere in a paper such as this. By the same token no real account has been taken of the many provisions and devices that have been developed outside Britain and New Zealand to combat this abuse. To attempt to discuss sensibly even the developments in Australia would be to convert this paper into a book.[62] Suffice it to say that each jurisdiction, given the peculiar characteristics of its markets and securities industry, will have to give special thought to fashioning its own anti-insider dealing mechanisms. It may look to the experience of others but to blindly or slavishly follow is a mistake.[63] No jurisdiction has succeeded in significantly combating this form of market abuse and perhaps given the nature of markets and men, none will!

FOOTNOTES

1. See generally B Rider and H L Ffrench, The Regulation of Insider Trading (1979) Macmillan

2. House of Commons Journals, 25 Nov 1696

3. See also concerning the ingenuity of the Rothchilds, 'Annals of Finance; A Reasonable Amount of Time' New Yorker 16 Nov 1968

4. See generally B Rider and H L Ffrench (supra) at 1, Ch 10 and J Farrar and M Russell, Company Law and Securities Regulation in New Zealand (1985) Butterworths, 251 et seq. See also E J Wright, 'Insider Trading in Corporate Securities - Can we learn from America?' (1971) 4 New Zealand Universities Law Review 210

5. See Final Report of the Special Committee to Review the Companies Acts (1973) Govt Printers. The MacArthur Committee recommended a partial codification of directors' duties along the lines proposed by the Jenkins Committee, in England, (see Cmd 1749 [1962]) reinforced by legislation similar to section 124A of the Australian Uniform Companies Act. See also G Dunning, The Regulation of Insider Dealing in Canada, Australia and New Zealand (1973) Unpublished LL.M thesis, University of Toronto; H L Ffrench, A Comparative Study of Insider Trading Regulation, (1978) Unpublished LL.M thesis, University of New South Wales and L.A. Style, Insider Trading Regulation in New Zealand; Could it be justified? (1986) Unpublished paper

6. See comments of Mr J Farrell, Executive Director, New Zealand Securities Common on Good Morning New Zealand 21 Oct 1986 at 8.00 hrs. Note also the observations of The Hon Dr A M Finlay, then Minister of Justice, to the New Zealand Society of Accountants,

   Dunedin, 13 Jan 1975 and Mr B C McLay, Assistant Secretary, Department of Justice to same Society, Wellington, 14 April 1978. Note also the Rt Hon David Lange's, Prime Minister, comments on possible conflicts in interest concerning certain appointments to the board of the Bank of New Zealand, 14 July 1986.

7. Mr C I Patterson, Chairman, New Zealand Securities Commission, address to The Institute of Chartered Secretaries and Administrators, Wellington, 20 April 1985. It seems that the cases that have been detected have most involved wives of insiders dealing in take-over situations.

8. See generally supra at 7, and letter from Mr C I Patterson to the Rt Hon G Palmer, Minister of Justice, 30 May 1986.

9. See D Chaikin, 'Cracking the nominee in New Zealand' (1982) 8 Commonwealth Law Bulletin 814.

10. See generally M Hetherington, 'Financing an insider take-over' (1976) Business Law Review 220; B Rider, 'Percival v Wright - Per Incuriam?' 40 Modern Law Review 471 and 'A Special Relationship on the Special Facts' 41 Modern Law Review 585

11. Guidelines for Securities Transactions by Directors of Companies (1982)

12. See supra at 8

13. B Rider and E J Hew 'The Regulation of Corporation and Securities Laws in Britain - The Beginning of the Real Debate' (1977) 19 Malaya Law Review 144.

14. See generally B Rider 'The Regulation of Insider Trading in the Republic of South Africa' (1977) 94 South African Law Journal 437; B Rider, 'The Regulation of Insider Trading in the Republic of Philippines' (1977) 19 Malaya Law Review 355 and B Rider and H L Ffrench, 'The Regulation of Insider Trading in Corporate Securities in France' (1977) 26 International and Comparative Law Quarterly 619.

15. See B Rider, The Promotion and Development of International Co-operation to Combat Commercial and Economic Crime (1980) paper submitted to the Commonwealth Law Ministers' Meeting in Barbados, 1980 at 18.

16. See H L Ffrench and B Rider, 'Should insider trading be regulated? Some initial considerations' (1978) 95 South African Law Journal 79 and R C A White, 'Towards a Policy Basis for the Regulation of Insider Trading' (1974) 90 Law Quarterly Review 493.

17. 'How Ethical Are Businessmen?' (1961) 39 Harvard Business Review 6; see also W Cary 'The Direction of Management Responsibility' (1963) 18 Business Lawyer 29 at 33.

18. Towards a Code of Business Ethics - A Consultative Document (Christian Association of Business Executives 1972) 26; and see also Simon Webley British Businessmen's Behaviour (Industrial Educational Research Foundation 1972).

19. B Rider, The Regulation of Insider Trading - A Comparative Analysis (1977) Unpublished Ph.D thesis, London University Vol III at 5.

20. B Rider, 'A flash in the pan?' (1987) 8 Company Lawyer 2.

21. But see the comments of their Lordships in National Westminister Bank v Morgan (1985) 2 WLR 588.

22. H Manne 'In Defence of Insider Trading' 44 Harvard Business Review 113

23. But see in the case of closely held companies, B Rider 'Partnership Law and its impact on domestic companies' (1979) Cambridge Law Journal 148

24. B Rider, Insider Dealing (1983) Jordans

25. H Manne, Insider Trading and The Stock Market (1966) Free Press, at 47.

26. Supra at 9 at 61.

27. Supra at 9 at 101.

28. See B Rider 'The Fiduciary and the Frying Pan' (1978) Conveyances 114.

29. 'Corporate Insider Trading and Stock Price Movements' Ph.D dissertation, University of Pennsylvania (1963) 118.

30. M C Fischer 'The Relationship Between Insiders' Transactions and the Price of Common Stock of their Respective Companies, the Standard and Poor's Stock Price Index and Price Stability' (1965) 205.

31. Louis Loss 'The Fiduciary Concept as Applied to Trading by Corporate "Insiders" in the United States' (1970) 33 Modern LR 34 at 36.

32. D M Feuerstein 'Securities and Exchange Commission Restrictions on the Use of Inside Information' Financial Executive December 1969 p 18.

33. Schotland, 'Unsafe at Any Price', 53 Va L Rev 1453. It is not without interest that the Court of Appeals for the Second Circuit (USA), in Securities and Exchange Commission v Texas Gulf Sulphur, in determining the appropriate test of materiality for inside information held 'the speculators and chartists of Wall and Bay Street are also reasonable investors entitled to the same protection afforded conservative traders', 401F 2d 833 at 848, Contra District Judge Bonsal at 258F Supp 280 (SDNY 1966).

34. B Rider 'Combating international commercial crime - A Commonwealth perspective' (1985) Lloyd's Maritime and Commercial Law Quarterly 217.

35. B Rider 'Insider Trading - A Question of Confidence' (1980) 77 Law Society's Gazette 113.

36. See generally B Rider 'The Regulation of Insider Trading in Hong Kong' (1975) 17 Malaya Law Review 310 continued (1976) 18 Malaya Law Review 157 and B Rider'Insider Trading - Hong Kong Style' (1978) New Law Journal 897.

37. The only jurisdiction which appears to have utilised the criminal law effectively in combating insider dealing is France. The French criminal procedure is particularly useful in investigating and dealing with such cases. See B Rider and H L Ffrench, 'The Regulation of Insider Trading in Corporate Securities in France' supra at 14, and A Tunc, (1981) 2 Company Lawyer 257 and (1983) 4 Company Lawyer 205.

38. See B Rider, Insider Trading (1983) Jordans at 44 et seq In Lord Advocate v. Bryce (1981) 21 August, Edinburgh Sheriff's Court, Bryce was given an absolute discharge; R v. Dickenson (1982) 10 May, Sutton Coldfield Magistrates' Court, Dickenson was sentenced to six months imprisonment, but this was suspended; R v. John and Joyce Titheridge (1982) 17 December, Croydon Crown Court, both fined $4,000; R v. Naerger (1986) 28 April, Guildhall Magistrates' Court, fined £800. The prosecution failed in three other cases.

39. See generally B Rider and H L Ffrench, The Regulation of Insider Trading (1979) Macmillan at 423 et seq.

40. Most of the discussion of in-house regulation in Britain has been in the context of conflicts of interest. See B Rider (Ed), The Regulation of The British Securities Industry (1979) Oyez, Chapter 5; R M Goode (Ed), Conflicts of Interest in the Changing Financial World (1986) Institute of Bankers and R Stewart, The Role of In-House Rules in Dealing with Conflicts of Interest in Financial Supermarkets (1985) Commercial Crime Unit, Commonwealth Secretariat, London.

41. See generally B Rider, D Chaikin and C Abrams, Guide to the Financial Services Act 1986 (1987) CCH.

42. See supra at 35.

43. See for example section 74 of the Ontario Securities Act and sections 58 and 59 of the Barbados Securities Exchange Act 1982.

44. See B Rider 'The Enforcement of Corporate Integrity with Particular Reference to the Role of Disclosure' in New Trends in Company Law Disclosure (L C B Gower, L Loss and A Sommers Eds)(1980) Harcourt Brace.

45. See B Rider, Insider Trading (1983) Jordans at 157 et seq.

46. See supra at 45.

47. See also in this regard EEC Directive on Admission of Securities to Official Listing 79/279/EEC, Schedule C, para 6 which imposes a general duty of timely disclosure.

48. B Rider, Report of an inquiry into the present arrangements for the detection, investigation and prosecution of commercial crime in Hong Kong, and proposals for the improvement of such arrangements, and an examination of the operation and organisation of the Securities and Commodities Commissions'(1981) Government of Hong Kong.

49. See generally B Rider and H L Ffrench, The Regulation of Insider Trading (1979) Macmillan at 179 et seq.

50. S Froomkin, 'Problems of Investigating and Prosecuting Commercial Crime Offences' (1985) 11 Commonwealth Law Bulletin 575; H L Ffrench, 'Pre-trial procedures in commercial crime within the Commonwealth' (1983) 9 Commonwealth Law Bulletin 655 and J Palmer 'Combating Commercial and Economic Crime in a Practical Way' (1985) 6 Company Lawyer 113.

51. B Rider, Insider Dealing Regulation - Not Worth Powder and Shot, Paper deliverd Insider Dealing Conference, Amsterdam Stock Exchange, 27 February 1987, and also 'Much ado about Nothing' (1986) 7 Company Lawyer 226.

52. See B Rider and H L Ffrench, The Regulation of Insider Trading (1979) Macmillan, Chapter 4.

53. See for example section 109 of the Financial Services Act 1986, B Rider, D Chaikin and C Abrams, Guide to The Financial Services Act (1987) CCH at 199.

54. See B Rider, 'The Companies Bill - Insider Trading' (1978) New Law Journal 1236, and note the comments of Professor L C B Gower in Review of Investor Protection, Part I (1984) Cmnd 9125 and Part II (1985) HMSO and Financial Services in The United Kingdom - A New Framework for Investor Protection. (1985) Cmnd 9432.

55. This was one of the problems of the ill-fated Council for the Securities Industry in Britain, see B Rider 'The British Council for the Securities Industry' (1978)

Revue de la Banque 197 and M Clarke Regulating the City - Competition, Scandal and Reform,(1986) Open University.

56. See B Rider 'Self-regulation: The British approach to policing conduct in the securities business, with particular reference to the role of the City Panel on Take-overs and Mergers in the regulation of Insider Trading' (1978) 1 Journal of Comparative Corporate Law and Securities Regulation 319 and B Rider and E J Hew, 'The role of the City Panel on Take-overs and Mergers in the regulation of insider trading in Britain' (1978) 20 Malaya Law Review 315.

57. See supra at 34 and D Chaikin, Mutual Assistance in Criminal Matters - A Commonwealth Perspective (1983) Commercial Crime Unit, Commonwealth Secretariat, London.

58. Re an inquiry under the Company Securities (Insider Dealing) Act 1985, Chancery Division, 31 March 1987.

59. See B Rider, Insider Trading (1983) Jordans; Gore-Browne on Companies (43 Ed) Chapter 12 (B Rider); B Rider 'Insider Trading as a Criminal Offence' (1982) 8 Commonwealth Law Bulletin 347; B Rider, 'Insider Dealing in Great Britain' (1981) Revista Della Societa 1. On the legislative background reference should be made to B Rider and H L Ffrench, The Regulation of Insider Trading (1979) Macmillan, Chapter 6; B Rider, 'The Conduct of Company Directors' (1978) New Law Journal 27; B Rider, 'Changes in Company Law' (1978) New Law Journal at 1116 and 1138 and B Rider 'Companies Bill, Insider Trading' (1978) New Law Journal 1236. On the most recent amendments see B Rider, D Chaikin and C Abrams, Guide to The Financial Services Act (1987) CCH, Chapter 7.

60. Sir Kenneth Berrill, at CCH Seminar, The Practical Implications of the Financial Services Act 28 January 1987, and see B Rider, Compliance and Enforcement - The Practical Implications of the Financial Services Act (1987) CCH.

61. Financial Times, 15 April 1987

62. Even the most recent proposals for amendment of the insider dealing law in Australia amount to a book - P Anisman, Insider Trading Legislation for Australia; An Outline of the Issues and Alternatives (1986) Australian Government.

63. Singapore has increasingly discovered this, in regard to the Australian law, but so have other jurisdictions, such as South Africa, Japan and the Philippines in regard to US law, see generally B Rider and H L Ffrench, The Regulation of Insider Trading (1979) Macmillan.