DUAL TRADING

IN THE NEW ZEALAND FUTURES MARKET

A DISCUSSION PAPER

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I INTRODUCTION

In 1990 the Securities Commission conducted an enquiry into trading in the Five Year Government Stock (No.2) Futures Contract on the New Zealand Futures & Options Exchange in 1989. This enquiry focused on the circumstances in which the trading rights of Jordan Sandman Futures Limited on the Exchange were suspended on 21 November 1989, the circumstances in which the Exchange suspended trading in the Five Year Government Stock (No.2) Futures Contract on 22 November 1989, the circumstances in which the decision to invoice back certain contracts on 22 November 1989 was made and the circumstances surrounding the expulsion of Jordan Sandman Futures Limited from the Exchange on 18 December 1989. During the enquiry the Commission considered:

(1) whether or not it should recommend changes to the rules or by-laws of the Exchange;

(2) whether or not it should recommend changes to the general regulations of International Commodities Clearing House Limited as the authorised clearing house to the Exchange;

(3) whether or not it should recommend regulations under section 41 Securities Amendment Act 1988;

(4) whether or not it should otherwise recommend changes to the law pertaining to the regulation of the Futures Industry in New Zealand.[1]

The Commission published a report on its enquiry, together with its recommendations, in November 1990.[2] On page 66 of the report the Commission noted that it had, during the course of the enquiry, received evidence that certain employees of trading Members of the Exchange were engaged in what is commonly referred to as "dual trading". The Commission stated that it proposed to release a separate report on this matter.[3]

II DUAL TRADING DEFINED

"Dual Trading" is "the practice of trading by a dealer in futures contracts in two capacities - that of a trader (or a principal) and that of an agent on behalf of a client in the same futures contract within a specified period of time."[4]

This discussion paper is primarily concerned with dual trading by employees of trading members of the Exchange and not by the trading members themselves. All persons whose evidence was used for this discussion paper have had the opportunity to comment on a confidential draft of the paper.

III EVIDENCE RECEIVED BY THE COMMISSION IN RELATION TO DUAL TRADING

During its enquiry into trading in the Five Year Government Stock (No.2) Futures Contract the Commission was informed that:

(1) some trading Members of the Exchange permit their employees to trade in futures contracts on their own account while executing client orders;

(2) some employees of trading Members of the Exchange have been trading in futures contracts on their own behalf, through the use of nominees;

(3) Some trading Members of the Exchange who allow their employees to engage in dual trading have an established procedure regarding the practice, for example, that employees must inform their supervisor of their trades and must comply with the usual deposit and margin payment requirements;

(4) the standard client agreement form used by Exchange Members contains a clause whereby the client consents to employees of the Member trading in futures contracts on their own account at the same time as they deal on behalf of the client;

(5) some employees of trading Members of the Exchange have taken advantage of information received from their clients when trading for their own account;

(6) some employees of trading Members of the Exchange have disregarded in-house procedures relating to dual trading by not informing their supervisors of their trading activity and not complying with deposit and margin payment requirements;

(7) when trading in futures contracts on their own account at the same time as they trade for clients, some employees of trading Members of the Exchange have been favouring their own trades over those of their clients.

Having received this information, the Commission decided that an enquiry into the practice of dual trading was necessary. The Commission was particularly interested in the responses of foreign jurisdictions to the practice. In conducting its investigation into dual trading the Commission recognised the need to take into account the differences in the manner in which futures contracts are traded in New Zealand and the manner in which they are traded on overseas exchanges. The major difference is that futures contracts in New Zealand are traded via an electronic screen trading system (the "ATS" system) whereas in overseas futures markets, trading is generally conducted on trading floors.

This report considers the propriety of the practice of dual trading in terms of the following:

(1) the nature of the practice - both in New Zealand and overseas;

(2) the arguments for and against the regulation of dual trading;

(3) the evidence received by the Commission during its enquiry into trading in the 5 year Government Stock No. 2 futures contract in 1989;

(4) the implications of the practice in terms of the fiduciary duty owed by an employee of a trading member to his/her employer and his/her employer's clients;

(5) the opportunity created by the practice for insider trading in the futures market;

(6) regulation of the practice in other jurisdictions.

Investors in the Five Year Government Stock No.2 Futures Contract and no doubt in relation to other futures contracts are almost invariably investors in the related bonds. The risks in one market may be substantially offset by a hedge in the other market. The Commission holds much evidence on bond dealing by Members of the Exchange or associated companies. However, we have not completed a detailed analysis of this or the relationship between bond dealing and futures dealing. We make no comment on questions which might arise in relation to dual trading on the bond market or in relation to arbitraging between the two markets in a dual capacity.

IV SCHOOLS OF THOUGHT IN RELATION TO DUAL TRADING

Market Liquidity

There is a school of thought which argues that dual trading brings certain benefits to futures markets. One of the benefits most often attributed to dual trading is that the practice improves market liquidity.[5] The "liquidity" of a market is its efficiency in absorbing trading orders without undue price fluctuations. Liquidity is a function of trading volume and of competitiveness among market participants. A market is liquid if it has the ability to satisfy orders of considerable magnitude without causing substantial price fluctuations.[6]

The pro-dual trading school of thought also argues that dual trading narrows bid-ask spreads. This is the difference between the bid price and the offer price. It is also argued that dual trading lowers trading costs for all market participants.[7]

Conflict of Interest

One of the principal concerns to which dual trading gives rise is that there is an inherent conflict of interest in a situation in which an employee of a trading member is able to trade in the same market contract both as a principal and as an agent.

Abuse of Customer Orders

It has been argued that dual trading makes possible the commission of certain types of trading abuses involving customer orders.[8] An example of the abuses which dual trading gives rise to is that if an employee of a trading member is able to trade on his own behalf in the same contract in which he is trading for a client, the client will suffer as the employee will favour his own trades ahead of those of his client, for example, the employee may place her/his own orders ahead of those of her/his client ("front running") or may trade for his/her own account using information received as a result of executing customer orders ("coat-tailing").

Opportunity for Insider Trading

It is also argued that dual trading creates the opportunity for insider trading in the futures market. Dual traders have an informational advantage whereas non dual traders are disadvantaged when trading opposite dual traders, who potentially can use information communicated by customer orders when trading for their own account.[9]

It should be noted that dual trading does not in itself constitute insider trading in the futures market. The ability of an employee of a trading member to trade on her/his own behalf at the same time and in the same contract market as she/he trades for her/his client creates the opportunity for that employee to engage in insider trading.

V UNITED STATES COMMODITY FUTURES TRADING COMMISSION STUDY ON DUAL TRADING

In November 1989 the United States Commodity Futures Trading Commission ("CFTC") published a study prepared by its division of economic analysis on the market effects of dual trading by floor brokers. The division of economic analysis examined an extensive record of trading activity through a variety of statistical and econometric methods in an effort to identify empirical regularities consistent with the claims commonly made with respect to dual trading. The activity reviewed all transactions in all contracts executed on ten exchanges for

15 trading days in 1988, including approximately 4.2 million futures transactions and 400,000 option transactions. For the purposes of the study, a dual trader was defined as a floor member of an exchange who executed trades for both a customer and his own account in the same contract, during the same trading session. This dual trading study reached the following conclusions:

(1) Dual traders do not, on average, secure better trades for their customers than non-dual trading brokers.

(2) Both dual traders and non-dual trading brokers provide liquidity when they engage in personal trading. There is, however, nothing unique or especially efficient about the manner in which dual traders provide liquidity.[10]

Given these conclusions regarding the presumed benefits of dual trading, the CFTC has formed the view that dual trading may not be necessary for adequate market liquidity and may not result in superior quality trade executions for customers.[11]

Contemporaneously with the study made by the CFTC division of economic analysis of the potential advantages of dual trading, the CFTC investigated the potential disadvantages of dual trading for futures markets. The CFTC concluded that the information derived from this investigation warranted a reassessment of the efficiency of existing rules in the US concerning dual trading and audit trail improvements to address the potential for trading abuses attributable to dual trading.[12] The CFTC concluded that dual trading creates an opportunity for brokers to take advantage of customer orders and consequently rendered certain illegal trading activity possible or easier to commit and more difficult to detect.[13] For example, dual trading could facilitate illegal conduct by making it relatively easy to transfer from one floor member to another the income earned when customers are defrauded.[14] The CFTC also noted that the appearance of impropriety which may be created by the practice of dual trading could lessen public confidence in the integrity of futures markets.[15] The CFTC concluded that while restricting dual trading might not eliminate all dual trading related trading abuses, such a restriction should deter those abuses.

The CFTC has acknowledged that the extent of actual trading abuses in which dual trading is a factor is indeterminate. However, it observes that the enforcement actions, indictments and plea agreements resulting from an undercover investigation of floor trading practices at the Chicago Mercantile Exchange and the Chicago Board of Trade indicate that some brokers have used their dual status to facilitate abuses of customer orders and that these abuses suggest a manner in which illegal conduct which goes undetected may occur.[16] The substance of the indictments and plea agreements also indicate that audit trails, however effective, cannot address all types of abuses facilitated by dual trading. Such systems, in certain instances, can detect trading patterns involving abuse of customer orders. However abuse might occur in isolation or otherwise may not be easily detectable from such record evidence.[17]

The Chicago investigation has shown that in the United States the ability of a dual trading floor broker to trade as both a principal and an agent during a single trading session provides that broker with opportunities to commit direct forms of abuse of customer orders which are not shared by non-dual trading brokers. Specifically, the Chicago investigation showed that a dual trading floor broker was able to commit the following abuses of customer orders:

(1) <u>Indirect Trading Against Customer Orders</u>

The CFTC has observed that this is the most common abuse facilitated by dual trading. In such cases, the dual trading broker buys (or sells) for the customer account from/ to another broker, then sells (or buys) the same number of contracts for his own account to/ from the same broker. Such a transaction leaves the other broker with no open position and a profit which may be passed back to the dual trading broker through other illegal trades. The CFTC gives the example of broker "E" selling to broker "O" 25 soyabean futures contracts for customers at $7.88 per bushel. Broker "E" then purchases for his own account from Broker "O" 25 contracts at $7.88 and a ½. Broker "O"s profits can later be passed to broker "E".[18]

(2) Off-setting Customer Orders

The indictments resulting from the Chicago Investigation also alleged an abuse in which dual trading floor brokers crossed customer orders by matching or "off-setting" a customer buy with a separate customer sell and executing them non-competitively opposite an accommodating broker. The CFTC gives the example of a broker purchasing for a customer two Japanese yen contracts from an accommodating broker at a designated price of 6874 and simultaneously selling two contracts for a customer to the accommodating trader at a designated price of 6872. These trades are arranged in order to pass money to a broker. Profits such as these are passed back to the broker through other illegal trades for the broker's personal account. The CFTC notes that one broker acknowledged in a plea agreement his participation in an on-going scheme in which brokers deliberately converted customer funds and market opportunities to their own use and the use of others.[19]

(3) Misallocation of Customer Orders

The indictments and plea agreements resulting from the Chicago Investigation also revealed trades in which dual traders simply misallocated customer orders or changed the price on customer orders already executed in order to benefit an accommodating trader.[20]

(4) Withholding Customer Orders

The Chicago investigation revealed instances where dual trading brokers simply withheld customer stop orders so as to execute those orders non-competitively with accommodating brokers, often after the close of trading. The orders were executed at prices calculated to provide a profit for the accommodating brokers, part of which was passed back to the broker's personal account through other illegal trades.[21]

(5) Disclosure of Customer Orders

In a number of plea agreements resulting from the Chicago investigation, brokers admitted to instances of illegal disclosure of customer orders. This involved secretly advising local traders of various customer orders held by the broker, thereby enabling the local trader to assume a market position that becomes profitable when trading against the secretly disclosed customer orders.[22]

It must be remembered that the above mentioned dual trading related abuses took place on exchanges where contracts are traded on a trading floor. The New Zealand Futures and Options Exchange, unlike most overseas exchanges, does not have a physical trading floor. Trading is carried out on computer terminals in each of the exchange's trading members' offices. This distinction must be borne in mind when considering the implications for the New Zealand futures market of overseas studies concerning the abuses of customer orders facilitated by the ability of a trader to trade in a dual capacity. However, while the removal of a trading floor may mean that abuses are more readily detected it may not necessarily remove the abuse of client orders to which dual trading gives rise. Indeed, the CFTC has observed that although the trade audit trail features of electronic trading systems such as the Chicago Mercantile

Exchange's Globex System have improved an exchange's ability to monitor for trading abuses, they do not necessarily eliminate the potential for abuse of customer orders when traders enter orders in a dual capacity.[23]

VI DUAL TRADING IN NEW ZEALAND - FINDINGS OF THE SECURITIES COMMISSION DURING ITS INQUIRY INTO TRADING IN THE FIVE YEAR GOVERNMENT STOCK (NO.2) FUTURES CONTRACT IN 1989

The terms of reference for the Securities Commission's enquiry into trading in the five year Government stock (no.2) futures contract in 1989 did not explicitly identify dual trading. The subject arose under the heading "any other matter relevant to the regulation of dealing in futures contracts in New Zealand".

During the above inquiry, the Commission was informed that it is "common practice" for employees of trading members to trade on their own behalf in the same contracts, and in the same trading session, in which they execute customer orders. The Commission also observed that dual trading is not at present prohibited by the rules and by-laws of the New Zealand Futures and Options Exchange. Of particular interest to the Commission was the evidence it received from an employee of a trading member of the Exchange ("employee X") concerning his dual trading activity. The following is an excerpt from the transcript of oral evidence given by this employee before the Commission:

Question: Did you trade for yourself (in futures contracts)?

Answer: Yes.

Question: Do you consider this to be ethical?

Answer: It is common practice for brokers to operate personal accounts, it did not affect my judgement when trading for clients.

Question: Were you trading against your clients?

Answer: Yes - there is no regulation prohibiting this.

Question: Would you not agree that some people would regard this as insider trading in the futures market?

Answer: Perhaps overseas, but I did seek a legal opinion on the matter.

Question: Did you tell them (the clients) when you took positions against them?

Answer: No.

Question: How many "ins and outs" would you have had over the whole period [with which the Commission's inquiry was concerned]?

Answer: In the vicinity of 1,500 contracts.

Question: Can you provide us with details of your trading in the physical [five year Government] stock?

Answer: All my trading was in futures.

Question: You at no stage left yourself in the position to make a deposit?

Answer: I made margin calls.

Question: Presumably, every time a client enters into a transaction with your firm a deposit is required?

Answer: No.

Question: Did you expose your creditworthiness (to your employer firm)?

Answer: I took myself on trust.[24]

After receiving the above evidence from Employee X, the Commission questioned other witnesses to the inquiry about dual trading. The Commission wanted to ascertain how widespread the practice is in New Zealand. The Commission also sought the witnesses' views as to the propriety of the practice.

Mr Gavin Kennedy, Chairman of the Exchange, informed the Commission that there had been considerable debate within the Exchange as to whether employees of trading members should be permitted to trade for their own account. Mr Kennedy informed the Commission that he personally had no objection to the practice so long as the employee was authorised to trade on his own behalf by his employer, the employer was aware of the employee's trading activity and so long as the trading took place in full public view.[25]

The Commission was informed by one dealer that its dealing staff occasionally traded in futures contracts on their own behalf. However, interest rate staff were not permitted to trade in interest rate futures contracts. Other than this, they had no internal guidelines or rules regulating trading in futures contracts by staff.[26]

Mr R.J. McKinlay, representing the National Provident Fund, informed the Commission that the policy of the NPF forbids its employees from trading for their own account in the markets in which they are dealing. The Commission then asked Mr McKinlay whether, in his capacity as a director of the Exchange, he considered it desirable that some sort of standard pertaining to employees trading on their own behalf should apply to all members of the Exchange. Mr McKinlay stated that, in his opinion, some sort of standard should be introduced.[27]

The Commission sought from Employee X written records of his trading activity during the period under inquiry. The Commission undertook an examination of these records. The available information revealed that Employee X established a client relationship with his employer firm through the use of two nominees. These will be referred to as Nominee A and Nominee B. These nominees completed the standard client agreement form used by Employee X's broking firm. The Commission noted that this agreement form stated the following:

> "(the firm) is authorised to execute transactions for the account of the client upon written or oral instructions of any person authorised to give instructions on that account whose name and signatures are set forth in the accounts schedule."

On the accounts schedule for each agreement under the heading "details of persons authorised to give instructions on this account" appears the name of Employee X.

The Commission also noted that the client agreement form also contained a clause stating as follows:

> "The client also acknowledges that any directors, managers or employees of (the firm) may trade or deal in futures contracts on their own behalf without conflict with the client's interests, provided also that trading occurs on the market and in accordance with the trading rules of the Exchange."

The Commission, on the basis of written records supplied by Employee X, has calculated that for the period 7/9/89 to 22/11/89 Employee X made a profit of $28,215 through trading in the name of Nominee A. The Commission has also calculated that in the same period Employee X made a profit of $151,272 through trading in the name of Nominee B. Thus, on the Commission's calculation, Employee X made a total profit of $179,487 during this period. It would therefore appear that, during the period with which the Commission's enquiry was concerned, Employee X was making substantial profits by trading on his own behalf through the two nominees.

In conducting this analysis of Employee X's trades, the Commission has observed a significant correlation between the dates on which Employee X executed the trades of a client ("the client") who was assuming a very substantial market position in the Five Year Government Stock (No. 2) futures contract and the dates on which he executed trades for his own account in the same contract market. This would indicate that Employee X was using information communicated by his client's orders when trading for his own account and either:

(1) engaged in "front running" (ie placing orders for his own account ahead of orders for the client); or

(2) "coat-tailing" the client's orders

The view that Employee X was engaged in frontrunning and coat-tailing in respect of the client's orders is supported by a written statement made by Employee X's supervisor at the broking firm and addressed to Employee X's employer:

> "(Employee X) made very substantial monies from trading in futures over the period of your investigation...it was not against company rules for him to trade, but:
>
> (a) I was supposed to know all staff trading, and
>
> (b) he was supposed to pay normal deposits." [28]

Employee X, in representations made later to the Commission, claimed that he was unaware of the rule requiring him to inform his supervisor as to his trading.

According to the employer, trading of Employee X through Nominee A and Nominee B tended to take two main forms:

(1) Where an instruction was received from the client, Employee X would place an order for Nominee A or Nominee B in advance of fulfilling client contracts; and

(2) Contracts bought or sold on behalf of the client during the course of trading would be assigned to Nominee A or Nominee B at the end of the day's trading.

The Commission notes Exchange by-law G.22 which prohibits "front running" by dealers (i.e. dealers placing orders for their own account ahead of the client). By-law G.22 states:

> "Orders received from clients and orders for a member's own account shall be executed by a member in the sequence in which they are received and recorded, unless it would be fair and equitable to allocate contracts obtained in respect of similar orders on the same day on a different basis; provided that where a different basis is used the member shall clearly define that basis and apply it to all instructions and orders without giving any preference any order for the account of the member."

The Commission observes that, on the evidence available to it, Employee X may have breached Exchange By-law G.22. This view was communicated to Employee X's employer at the time of the original enquiry.

The Commission's Observations

The Commission, as a result of its inquiries, considers that:

(1) dual trading by employees is practised in the New Zealand futures market,

(2) Dual trading is not prohibited by the rules and by-laws of the New Zealand Futures and Options Exchange.

(3) While some entities, such as the National Provident Fund, do not allow their employees to trade on their own behalf in the markets in which they are dealing, other broking firms permit their staff to engage in dual trading. Indeed, the standard client agreement forms used by broking firms contains a clause whereby the client consents to the employee trading on his own behalf in the same futures contract as her/him and trading against her/him.

(4) Dual traders are in a position to take advantage of information communicated by client orders when trading for their own account.

(5) In the case of Employee X, it would appear that large gains were made from dual trading.

(7) It would appear that, in trading for his own account, Employee X may have breached rules and procedures established by his employer.

(8) It would appear that Employee X may have placed orders for his own account in advance of orders for his client, in breach of Exchange By-law G.22.

(9) The use of automated trading in New Zealand, coupled with the Exchange's inspection procedures, does provide a facility for detecting abuses but there are still opportunities for avoiding detection.

VII THE FIDUCIARY DUTIES OWED BY THE DUAL TRADING EMPLOYEE TO THE EMPLOYER AND THE EMPLOYER'S CLIENTS

A principal area of concern in relation to dual trading is the fiduciary duties owed by the dual trading employee. The Commission observes that an employee of a trading member of the Exchange who, in the course of her/his employment, deals in futures contracts is subject to the following fiduciary duties:

(1) A duty owed to the clients for whom she/he executes orders, and
(2) A duty owed to her/his employer.

Does dual trading constitute a breach of these duties?

It is a well established rule of equity that a person who is subject to a fiduciary duty is under a fundamental duty to avoid a situation of possible conflict between self interest and duty. This rule was observed as far back as 1726 in

Keech v Sandford[29] where it was applied by Lord Chancellor King to trustees. Moreover, as was noted in Keith Henry & Co. Pty Ltd v Stuart Walker & Co. Pty Ltd[30] in 1958 the rule is not confined to cases of express trust. It has been applied as between partners, as between principal and agent and as between master and servant.

The strictness of the rule observed in Keech v Sandford was affirmed in 1854 in Aberdeen Railway v Blaikie[31]. Here Lord Cranworth observed:

> "A fiduciary is one who has undertaken ... to act on behalf of another in circumstances in which equity will not allow him to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect."[32]

The strictness of this statement is to be noted. According to Lord Cranworth, the mere possibility of a conflict of interest is sufficient to establish liability. There does not have to be an actual conflict.

Furthermore, the Courts have held that a person under a fiduciary duty may not gain a profit from his position. In Bray v Ford[33] Lord Herschell stated:

> "It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondents, is not, unless otherwise expressly provided, entitled to make a profit."[34]

Lord Russell in Regal (Hastings) Ltd v Gulliver[35] stated:

> "The liability arises from the mere fact of a profit having been made. The profiteer, however honest and well intentioned, cannot escape the risk of being called to account."

The rule that a fiduciary must not profit from his position was reasserted by Lord Denning in Boardman v Phipps[36]

"It is quite clear that if an agent uses property, so as to make a profit for himself out of it, without his principal's consent, then he is accountable for it to his principal ... so also if he uses a position of authority, to which he has been appointed by his principal, so as to gain money by means of it for himself, then he is also accountable to the principal for it, see Reading v Attorney General. Likewise with information or knowledge which he has been empowered by his principal to collect or discover, or which he has otherwise acquired for the use of his principal, then again if he turns it to his own use, so as to make a profit by means of it for himself, he is accountable ... for such information or knowledge is the property of his principal, just as much as an invention is ..."[37]

These rules pertaining to fiduciary duties have been reinforced by the New Zealand Courts. In New Zealand Netherlands Society "Orange" Inc. v Kuys[38] the Judicial Committee of the Privy Council held that the obligation upon a fiduciary not to profit from a position of trust and not to allow a conflict to arise between duty and interest is one of strictness. Here Lord Wilberforce noted:

"The obligation not to profit from a position of trust, or, as is sometimes relevant to put it, not to allow a conflict to arise between duty and interest, is one of strictness. The strength, and indeed the severity, of the rule has recently been emphasised by the House of Lords (Boardman v Phipps). It retains its vigour in all jurisdictions where the principles of equity are applied. Naturally it has different applications in different context. It applies, in principle, whether the case is one of trust, express or implied, of partnership, of directorship of a limited company, of principal and agent, or master and servant, but the precise scope of it must be moulded according to the nature of the relationship."[39]

More recently, in 1985, in Westpac Banking Corporation v Savin[40] Richardson J. stated:

"The fiduciary must act with absolute openness and fairness to his client. He must not place himself in a position where his duty and interest may conflict (Boardman v Phipps [1967]).

The fiduciary must not without the informed consent of his client stand to receive any benefit other than his personal remuneration from the transaction which he is retained to carry through." [41]

These rules pertaining to fiduciary duties have been reaffirmed by Davison C.J. in Pacifica Shipping Co. Ltd v Anderson[42] in the context of the duties of company directors and agents, and the Court of Appeal in Farrington v Rowe McBride & Partners[43], Day v Mead[44] and, most recently, in Mouat v Clark Boyce[45] in the context of solicitors' duties to their clients.

In summary, there is a fundamental duty on the part of a fiduciary to avoid even the possibility of a conflict between his duty and his self interest without the informed consent of the person to whom he owes the duty. In particular, a fiduciary can never safely use his position or information gained from it, in order to make a profit for himself, unless he makes a full disclosure to the person to whom he owes a fiduciary obligation and obtains that person's consent. This rule is to be applied rigorously, and liability arises from the mere fact of a profit having been made.

As previously noted, an employee of a trading member who deals in futures contracts is subject to the following fiduciary duties:

(1) a duty owed to the clients for whom he/she execute orders; and

(2) a duty owed to his/her employer.

The implications of dual trading in respect of each of these fiduciary relationships will be considered in turn.

(1) The fiduciary duty owed by an employee of a trading member to the clients for whom he/she executes orders

The relationship between employees of trading members and their clients is that of agent and principal. The employee (the agent) trades in futures contracts on behalf of the client (the principal) in accordance with the client's instructions. Given this agent/principal relationship and applying the rules pertaining to fiduciaries, employees of trading members have a fundamental duty to avoid not only a conflict between their duty to their clients and their own self interest, but even the possibility of such a conflict. The Commission observes that dual trading by an employee of a trading member creates, at the very least, the possibility for a conflict between fiduciary duty and self interest. This is sufficient to constitute a breach of the fiduciary duty owed by the employee to the clients.

As noted previously, however, trading members of the Exchange have a clause in their client agreements whereby the client consents to employees of the trading member dealing on their own behalf at the same time as they deal for the client. This would appear to negative any breach of fiduciary duty which might otherwise occur. In the case of a standard form contract this provision would need to be drawn clearly to the client's attention. However, regardless of whether the consent of the client is obtained, wider ethical questions are raised by dual trading.

(2) <u>The fiduciary duty owed by employees of trading members to their employers</u>

Here the fiduciary relationship is one of master and servant. The employee has a fundamental duty to avoid a conflict between his duty to his employer (i.e. the broking firm) and his own self interest. The Commission considers that the practice of dual trading by an employee of a trading member without the informed consent of her/his employer constitutes a breach of the employee's fiduciary duty to her/his employer. By dealing in futures contracts on his own behalf during his employment, the possibility for a conflict between his duty to his employer and his own self interest exists.

As noted previously, some trading members of the Exchange permit their employees to engage in dual trading in certain circumstances. The Commission understands that some trading members who permit dual trading have a procedure which is to be adhered to by those employees who trade for their own account, for example, that the employee must fully inform his supervisor as to his trading activity and must meet the usual deposit and margin requirements. The Commission observes that in situations where trading members allow their employees to trade on their own behalf at the same time as they execute client orders and where employees comply with any established procedure concerning dual trading and fully account to their employer for any profit made as a result of such trading, then the fiduciary duty of the employee to the trading member is not breached. However, the evidence received by the Commission indicates that some employees may be ignoring established procedures concerning dual trading and not fully accounting to their employers for any profit made.[46]

VIII DUAL TRADING AND INSIDER TRADING IN THE FUTURES MARKET

Insider trading is:

> "the buying or selling of securities by a person who, by virtue of his position or some connection (i.e. with a company) has the benefit of information not generally available." [47]

Insider trading is undesirable because it gives the insider an unfair advantage over other market participants. Where insider trading occurs, non insiders are inclined to distrust the market. They can never be sure that the person with whom they deal is not trading on the basis of inside information. This hampers the efficiency of the market and may discourage investment.[48]

In December 1987 the Securities Commission published a report to the Minister of Justice concerning insider trading in the New Zealand share market. In that report the Commission recommended the following principles in relation to the trading of shares on the New Zealand Stock Exchange:

> "(a) An insider in relation to a company should not buy or sell a security of the company while he has, by reason of his position as an insider, information that has not been published and that would be likely to affect the price of the security if it was published;
>
> (b) An insider in relation to a company should not buy or sell a security of another company while he has, by reason of his position as an insider, information that has not been published and that would be likely to affect the price of the security if it was published;
>
> (c) An insider who is for the time being inhibited by clause (a) or clause (b) from buying a security should not:
>
> (i) Advise or procure any person to buy or sell, or to advise or procure any other person to buy or sell, such a security, or
>
> (ii) Communicate the 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 in buying or selling, or advising or procuring any other person to buy or sell, such a security." [49]

In view of these principles, the Commission recommended that legislation be enacted:

> "(1) To implement the Commission's 1982 proposals for the reporting of substantial shareholdings and interests in shares in listed companies.
>
> (2) To confer, in certain cases, upon every person who buys a security from, or sells a security to, an insider and suffers loss because the insider has information in confidence that is relevant to the transaction, the right to recover compensation for that loss from the insider.

(3) To confer, in certain cases, upon companies the right to recover from insiders who buy or sell securities while they have in confidence information relevant to the transaction, sums of money equal to the gains obtained or the losses avoided together with civil penalties.

(4) To confer upon the Court jurisdiction to disqualify an insider trader from holding office in a company.

(5) To confer upon the Court jurisdiction to revoke a sharebroker's licence where the licensee has traded as an insider." [50]

The Commission's recommendations are generally reflected in the insider trading provisions of the Securities Amendment Act 1988. These provisions are designed to eliminate insider trading in securities listed on the New Zealand Stock Exchange. The basic principle underlying the legislation is that an insider who obtains price sensitive information by virtue of his or her position as an insider should be prohibited from dealing in securities or tipping (i.e. advising or encouraging the purchase or sale of securities to other persons) until the information is published or otherwise reflected in market prices.[51] There is no criminal liability under the legislation for insider trading, but the insider may be liable to pay damages to the party with whom he or she trades and liable to the public issuer concerned in respect of gains made or loss avoided.[52]

In its report to the Minister of Justice, the Commission considered insider trading in terms of the following considerations:

(1) Morality
(2) Fairness
(3) Fiduciary Duty
(4) Integrity of Financial Markets
(5) Market Efficiency
(6) International Comity [53].

The Commission believes that these considerations may also be applied when considering insider trading in the futures market. The Commission believes that, as in the case of the share market, these considerations condemn insider trading in the futures market. While dual trading does not, in itself, constitute insider trading, the practice of permitting dual trading creates the opportunity for employees of trading members to trade on inside information.

IX THE TREATMENT OF DUAL TRADING IN OTHER JURISDICTIONS

The Securities Commission has consulted with representatives of overseas futures exchanges and futures market regulatory agencies as to their views on the propriety of dual trading and the rules of their respective jurisdictions in relation to the practice.

1. Australia

Representatives of the Sydney Futures Exchange informed the Commission that the Sydney Exchange views dual trading as a totally unacceptable practice. Thus clause G.10(c) of the by-laws of the Sydney Futures Exchange states:

> "No market representative or trainee or sycom operator shall at any time trade on any market of the exchange for his personal account. For the purpose of this sub clause a person shall be deemed to have traded for his personal account if he trades in any entity (other than the floor member of which he is a director, partner or employee):
>
> (1) In which he has a beneficial interest; or
>
> (2) Over which he exercises any control; or
>
> (3) Which is a corporation in whose shares he has a "relevant interest" as that term is defined by section 8 of the Companies Code." [54]

2. The United States of America

During hearings preceding the enactment of the Commodity Exchange Act amendments in 1974, concern was expressed by Congress about dual trading. From these concerns emerged a new section 4j of the Commodity Exchange Act and, subsequently, a series of new regulations by the CFTC designed to reduce the risk - and improve the detection - of trading abuses facilitated by dual trading. The CFTC was directed to "make a determination" as to whether floor brokers and futures commission merchants would be allowed to continue to make personal trades while also handling customer orders and, if so, the Commission was instructed to adopt regulations containing the "terms, conditions and circumstances" under which the practice would be allowed.[55] In the meantime it has adopted regulations setting standards for this activity and intended also to generate information sufficient to assess whether dual trading poses the risks with which Congress was concerned.[56]

Accordingly, Part 155 of the Regulations of the CFTC sets forth certain standards to be met by both floor brokers and futures commission merchants. These standards are largely devoted to assuring a customer first policy by floor brokers and futures commission merchants.[57]

Regulation 155.2 sets standards for floor brokers and is intended to ensure that customers depending on floor brokers for order execution are treated with priority and fairness. Sub-sections (a) and (b) of Regulation 155.2 provide that a floor broker may not trade in a commodity for his or her own benefit while holding a customer order in the same commodity that can be executed either at the current market price or at the same price as the floor broker's trade. Sub-section (c) of Regulation 155.2 prohibits a floor broker from executing for customer accounts over which he or she has "trading authority". All such orders must be placed with another floor broker for execution. A floor broker is deemed to have such "trading authority" if he or she can initiate trades for customers without their prior approval, but not where the floor broker's discretion is limited to such things as the precise time and price at which a customer originated order may be executed. The CFTC has stated that this prohibition is designed to prevent floor brokers from placing their personal trading interests ahead of their customers' interests when exercising trading discretion over such customers' accounts.[58]

Sub-sections (e), (f) and (h) of Regulation 155.2 deal with non-competitive activity by floor brokers in connection with customer orders. Thus, a floor broker may not take the other side of a customer's order without the customer's prior consent and, even with consent, may do so only in conformity with contract market rules approved by the Commission.[59]

The requirements of Regulation 155.2 are required to be incorporated by contract markets in their own rules. In this manner, violations by floor brokers become grounds for Exchange disciplinary proceedings and contract markets may be sanctioned by the Commission for failure to enforce those requirements on their floor brokers. As contract market trading requirements, these rules must be enforced by the Exchanges due to section 5a(8) of the Commodity Exchange Act.[60]

Trading standards with respect to futures commission merchants and their affiliated persons (partners, officers, directors, owners of more than 10% of equity interest, correspondents, agents, associated persons or employees of a futures commission merchant or introducing broker, relatives, spouses or relatives of spouses who share the same home as any of the enumerated affiliated persons) are set forth in Regulation 155.3 of the CFTC regulations and, like Regulation 155.2 for floor brokers, are designed to ensure that futures commission merchants and their affiliated persons practice a customer first policy in their business dealings. Unlike Regulation 155.2, however, Regulation 155.3 imposes these duties directly on futures commission merchants and affiliated persons, without any requirement that the contract markets adopt any implementing rules.[61]

Sub-section (a)(1) of Regulation of 155.3 requires each futures commission merchant to establish and enforce "internal rules, procedures and controls" to ensure, to the extent possible, that customer orders executable at or near the current market price are "transmitted to the floor" of the Exchange ahead of pending orders "in the same commodity" placed for proprietary accounts, for affiliated persons; or for accounts where an affiliated person has authority to initiate trades, if the affiliated person has prior knowledge of the customer orders. Here the intention of the CFTC is to ensure that futures commission merchants and their employees do not take advantage of their relationship with customers by using their knowledge of customer orders to trade ahead of or against the interests of such customers for their own benefit or for that of their preferred customers.[62]

Sub-section (a)(2) of Regulation 155.3 directs all futures commission merchants to adopt and enforce systems to prevent affiliated persons from evading the customer first rule by using another futures commission merchant for that purpose.[63]

Sub-section (b)(2) of Regulation 155.3 repeats the prohibition against taking the other side of a customer's order without his or her prior consent.[64]

Thus, although CFTC regulations currently do not prohibit dual trading, certain regulations exist which reduce the potential of dual trading abuse by floor brokers.

At present, three futures exchanges in the United States restrict dual trading. The AMEX Commodities Corporation, the Philadelphia Board of Trade and the Chicago Mercantile Exchange.

AMEX Commodities Corporation

Rule 641 (a) states:

> "A registered commodities trader may not initiate on the floor of the Exchange a transaction for an account in which he or his member organisation has an interest and execute as broker an off floor order or an order received from another floor member in the same commodity interest during the same session."[65]

Philadelphia Board of Trade

Rule 342(a) states:

> A registered commodities trader may not initiate on the floor of the Exchange a transaction for an account in which he or his member organisation has an interest and execute as broker an off floor order or an order received from another floor member in the same commodity interest during the same trading session."[66]

Chicago Mercantile Exchange

Rule 541 prohibits brokers who are standing on the top step of the Exchange's S & P 500 futures pit from trading an S & P 500 futures contract for their own account.

On 21 December 1990 the Chicago Mercantile Exchange submitted proposed rule 552. This rule, with certain exceptions, would restrict dual trading across all "mature and liquid" CME futures and option contract months, as defined in the proposed rule. Dual trading would be defined under the proposed rule as:

> "Trading or placing an order for one's own account, an account in which one has a direct or indirect financial interest or an account which one controls, in any contract month in which such person previously executed, received or possessed a customer order on the Exchange floor during the same regular trading hours session."

The scope of this dual trading restriction would extend to trading in any "mature and liquid" contract month, defined as one which has a daily average volume of 10,000 contracts during the prior six calendar months. The proposed trading restriction would not encompass trading for a direct or indirect financial interest or controlled account in different contract months of the same commodity.[67]

Proposed Commodities Futures Trading Commission Regulations Relating to Dual Trading on United States Futures Exchanges

Following upon:

(1) the findings of the division of economic analysis of the CFTC in relation to the purported benefits brought to futures markets by dual trading, and

(2) public information resulting from the undercover investigation of floor trading practices at the Chicago Mercantile Exchange, and

(3) studies that have shown that current audit trail systems are not capable of detecting all abuses relating to dual trading,

the Commodities Futures Trading Commission, in January 1990, proposed a regulation (regulation 155.5) which would prohibit a floor broker, during the same trading session, from:

(1) Trading or placing an order for a futures or option contract for his own account, an account over which he has a trading discretion, or an account in which he had a significant interest; and

(2) Holding or executing an order for a futures or option contract in the same commodity for a customer, during the same trading session, except to the extent permitted by contract market rules.[68]

The proposed regulation would be phased in on an incremental basis in accordance with a 12 month dual trading restriction implementation plan. In accordance with this plan, the proposed restriction on dual trading would initially apply to one or two of the most actively traded commodities on each of the seven largest futures exchanges in the United States. The amount of effected activity is intended to be sufficient to permit an adequate assessment of the advantages and disadvantages of the proposed restriction.[69]

In proposing this regulation the CFTC expressed the concern that the appearance of impropriety which may be created by dual trading lessens public confidence in the integrity of futures markets.[70]

The proposed restriction would prohibit a broker, during any trading session in which he holds or executes a customer order, from trading in the same commodity for the broker's own account, an account over which he has a trading discretion, or an account in which his ownership interest or share of the profits is 10% or more. The broker would be prohibited from trading for such accounts either directly (i.e. by executing a transaction) or indirectly (i.e. by placing, modifying or cancelling an order). The same broker, however, could trade for such accounts and for customers in different commodities. The same broker could also trade for such accounts and for customers in the same commodity during different trading sessions.[71]

The CFTC states that the proposed regulation is intended to promote the integrity of futures markets by limiting illegal conduct resulting from the ability to trade in two capacities.[72] Specifically, the CFTC is of the view that the proposed regulation should make it more difficult for floor traders to abuse their fiduciary responsibilities with regard to customer orders. The CFTC believes that restricting dual trading should not only render certain abuses more difficult to commit but also improve the ability of contract markets to meet their compliance and surveillance responsibilities.[73] The CFTC has emphasised that public confidence in the integrity of the futures markets is necessary if these markets are to fulfil their functions. The CFTC is of the view that dual trading weakens public confidence in futures markets.[74]

In March 1992 the CFTC informed this Commission that the CFTC is currently considering submissions in relation to the proposed regulation.

3. The United Kingdom

As at December 1990, the rules of the Association of Futures Brokers and Dealers in the United Kingdom ("AFBD") specifically dealt with the question of dual trading. Rule 5.17.1 stated:

> "A member firm shall take all reasonable steps to ensure that an officer or employee of the member firm does not, for his own personal account or for that of any person connected with him:
>
> (a) Effect any transaction which he knows, or ought to know, to be forbidden under these rules;
>
> (b) Acquire or dispose of any investment which he knows or ought reasonably to know, would involve him in a conflict of his own interest or that of a person connected with him, with that of any customer or with his duty to any customer;
>
> (c) Effect any transaction relating to an investment of any

description dealt in by the member firm without first obtaining its consent pursuant to rule 5.17.2 and thereafter and forthwith identifying the transaction and informing the member firm that it has been so effected; or

(d) Effect any transaction relating to an investment of any description dealt in by the member firm with or through the agency of another authorised person, without informing that other authorised person he is an officer or an employee of the member firm and shall not request or accept from that other authorised person any credit or special dealing facilities in connection with the transaction without the specific consent of the member firm."

Rule 5.17.2 stated:

"For the purposes of rule 5.17.1(c), the consent of the member firm may be a general consent relating to all transactions, except where the transaction is effected by an employee (other than a person recognised by the exchange on which the transaction is entered into as a "local") with a customer of the member firm (other than a market counterparty) in which case the consent must be specific to the transaction in question."

Rule 5.17.3 stated:

A person is connected with an officer or employee of a member firm if he is so connected by reason of any domestic or business relationship (other than because he is a customer of the member firm) that that officer or employee can reasonably expect to have influence over that person's judgement in investment matters or to be consulted by that person before any such judgement is made."

Rule 5.17.4 stated:

"A member firm shall ensure that each of its officers and employees:

(a) Is provided with a written notice setting out the rules in this paragraph 5.17; and

(b) Is required to observe such rules pursuant to either a term inserted in his contract of employment or a separate undertaking signed by him."

Rule 5.17.5 stated:

"A member firm which effects a transaction in an investment with or on behalf of a customer whom it knows to be an officer or an employee of a person who carries on investment business in relation to investments of that description shall, unless it has good reason to believe that that person has consented, inform that person of the effecting of the transaction, its terms and the identity of the parties to it."

Rule 5.17.6 stated:

"A member firm shall take all reasonable steps to procure that each officer and each employee of the member firm shall take all reasonable steps within his power to ensure that any person connected with him, when acting on his own account, observes the rules under this paragraph 5.17 as though they applied to that person:

SAVE THAT this rule shall not apply if:

(1) The person so connected is an officer or employee of another authorised person acting on his own account in connection with a transaction relating to an investment of a description in which that authorised person carries on investment business; and

(2) The officer or employee of the member firm is either not aware of the actions of the connected person, or has no reasonable grounds for believing that the connected person has been influenced by the officer and employee and would undertake those actions; or, being aware of those actions, has reasonable grounds for believing that he has not influenced that person's judgement and has not been consulted by him in respect of them."

These rules provided a comprehensive regulatory framework for trading by employees of member firms. An analysis of these rules shows an effective prohibition of dual trading by employees of member firms. Rule 5.17.1(b) prohibited an officer or employee of a member firm, for his own personal account or for that of any person connected with him, acquiring or disposing of any investment which he knew, or ought reasonably to have known, would involve him in a conflict of his own interest, or that of a person connected with him, with the interest of any customer or with his duty to that customer. As has been observed earlier in this report, dual trading creates, at the very least, the potential for such a conflict between the interest of the employee and the interest of the customer.

It should also be noted that under the AFBD rules the obligation to prevent such situations of conflict of interest arising did not fall upon the employee. It fell upon the member firm. Furthermore the prohibition also extended to employees trading on behalf of persons deemed to be connected with the employee (i.e. a person who is in a domestic or business relationship with the employee whereby the employee can reasonably be expected to have some influence upon that person's judgement in investment matters or to be consulted by that person before any such judgement is made).

In addition to the prohibition on employee trading where it gave rise to a conflict of interest, there were further restrictions upon employee trading. An employee could not deal on his own account or for a connected person in an investment dealt in by the member firm without first obtaining the member firm's consent (Rule 5.17.1(c)).

An employee could not, for his own account or for a connected person, effect any transaction relating to an investment dealt in by his employer through the agency of another authorised dealer without informing that authorised dealer that he was an employee of the member firm (Rule 5.17.1(d)) and that authorised dealer was under an obligation to inform the member firm of the transaction (Rule 5.17.5). In short, the AFBD rules provided for a comprehensive system of checks and balances in the area of employee trading.

Another noteworthy feature of the AFBD rules was the obligation upon the member firm to ensure that its employees sign an undertaking to observe the above rules (Rule 5.17.4).

On 1 April 1991 the Associations of Futures Brokers and Dealers merged with the Securities Association Limited to form the Securities and Futures Authority ("SFA"). The SFA has informed this Commission that the above AFBD rules concerning employee trading are still in place for derivative firms. The SFA has also informed this Commission that dual trading is an area which the SFA monitors closely.

4. France

In France an employee of a market participant who is in charge of trading on a specific contract is not allowed to trade in that contract for his own account.[75]

5. Ontario

The by-laws of the Toronto Futures Exchange prohibit dual trading by providing that no floor trader may buy or sell for his own account (or for any account in which he or she has an interest) any series of a TFE futures contract while holding an order for a client account of the same class which is executable at the market price or at the price at which a transaction can be made for the floor trader's own account or the account in which he has an interest. The TFE also prohibits floor traders from taking the other side of a transaction while holding an order from a client.[76]

Observations

The Commission observes that dual trading is viewed as a serious matter in other jurisdictions. In some jurisdictions employees of market participants are not permitted to trade for their own account. In other jurisdictions, while employees of market participants are permitted to trade for their own account, there are rules as to the manner in which and the time at which such trades are to be conducted. However, as can be seen in the case of the United States, recent studies have called this view into question while the disadvantages of permitting dual trading (abuse of client orders, dealers preferring their own trades over the trades of their clients, creating the opportunity for dealers to trade on inside information) are now being seen as outweighing any arguments in favour of permitting the practice. Hence the proposal in the United States by the CFTC to prohibit dual trading in selected contracts on a trial basis.

It should be noted that the above analysis is only an analysis of the rules of other jurisdictions in relation to dual trading. These jurisdictions also have extensive rules relating to insider trading in futures markets.

X DEVELOPMENTS IN NEW ZEALAND IN RELATION TO THE REGULATION OF DUAL TRADING

The Securities Commission has been informed by the New Zealand Futures and Options Exchange that it proposes to introduce a new Exchange rule in relation to dual trading. The proposed rule states:

> "No director or employee of, or partner in, a Trading Permit Holder, who is a Trading System Operator, may have a direct or indirect beneficial interest in any Contract traded on the Exchange. For the purposes of this rule 16.4 a Trading System Operator shall be deemed to have a beneficial interest in any Contract which is traded for the account of any entity (other than the Trading Permit Holder of or in which they are a director, employee or partner) over which they have control."

We would expect the Exchange, consistent with this proposed change, to modify the terms of the client agreement form as quoted on p.14 of this discussion paper.

XI QUESTIONS FOR CONSIDERATION

The Commission believes the following questions need to be considered in relation to dual trading in the New Zealand futures market:

(1) Should the New Zealand Futures and Options Exchange introduce rules in relation to dual trading by employees?

(2) If so, should these rules:

(a) prohibit dual trading entirely; or

(b) only prohibit dual trading in certain circumstances; or

(c) merely establish procedures to be followed by dual traders?

(3) To whom should any rules in relation dual trading apply? Should they be restricted to the person who enters the trades into the ATS system ("the trading system operator") or should they also apply to other personnel in the broking firm, for example the trading system operator's supervisor?

(4) What sort of interests in futures contracts should any rules in relation to dual trading cover?

(5) Is there any advantage to the New Zealand Futures and Options Exchange adopting the same rule as the Sydney Futures Exchange?

The rule proposed by the New Zealand Futures and Options Exchange addresses these questions. It proposes that:

(1) there should be a rule restricting dual trading;

(2) the rule would apply to all employees, directors and partners of broking firms who are trading system operators;

(3) the rule would not apply to the employer, being the authorised dealer.

(4) the rule would apply to both direct and indirect beneficial interests in futures contracts. The Commission notes that the rule would define a "beneficial interest" as an interest in any contract which is traded for the account of any entity over which the trading system operator has control. The question is raised as to whether a wider definition of "beneficial interest" is desirable. For example, one may have a beneficial interest in an entity but may not have control over that entity. Should the definition of "beneficial interest" be extended so as to include trading by spouses, close relatives and related companies?

The Commission welcomes comments in relation to these questions.

In the case of respondents who are futures dealers, the Commission would appreciate a statement of existing policy in relation to trading in futures contracts by employees.

The Commission would appreciate comments by no later than 1 November 1992.

P.D. McKenzie
Chairman

30 July 1992

FOOTNOTES

1. Terms of Reference, enquiry of the Securities Commission into trading in the Five Year Government Stock (No. 2) Futures Contract on the New Zealand Futures and Options Exchange in 1989, 15 February 1990.

2. <u>Report of the Securities Commission on its enquiry into trading in the Five Year Government Stock (No. 2) Futures Contract on the New Zealand Futures and Options Exchange in 1989</u>, 1 November 1990.

3. Ibid, p.66

4. United States Commodity Futures Trading Commission, "Proposed Rule Concerning Restriction on Dual Trading by Floor Brokers", <u>Federal Register</u> Vol 55, No. 8, Thursday, January 11 1990, p.1048.

5. Op Cit.

6. Philip McBride Johnson and Thomas Lee Hazen, <u>Commodities Regulation</u> Second Edition, Little, Brown & Company (Canada) Limited, 1989. V.II p.145.

7. Above No. 4.

8. Op Cit.

9. Op Cit.

10. Ibid, p.1049.

11. Op Cit.

12. Op Cit.

13. Ibid, p.1050.

14. Op Cit.

15. Op Cit.

16. Op Cit.

17. Op Cit.

18. Ibid, p.1051.

19. Op Cit.

20. Op Cit.

21. Op Cit.

22. Op Cit.

23. Ibid, p.1057.

24. Transcript of evidence given before the Securities Commission during its enquiry into trading in the Five Year Government Stock (No. 2) Futures Contract on the New Zealand Futures and Options Exchange in 1989, 6 June 1990.

25. Op Cit.

26. Op Cit.

27. Ibid, 5 June 1990.

28. Received in evidence by the Commission during its enquiry into trading in the Five Year Government Stock (No.2) Futures Contract on the New Zealand Futures and Options Exchange in 1989.

29. (1726), 25 E.R. 223, Sel. Cas. T. King 6.

30. (1958) 100 CLR 342,350.

31. (1854) 1 Marcq 461.

32. Ibid, 471.

33. [1896] AC 44.

34. Ibid, 51-52.

35. [1967] 2 AC 134, [1942] 1 All E.R. 373.

36. [1967] 2 AC 46, [1966] 3 All E.R. 721 affirming, [1965] 1 Ch 992, [1965] 1 All E.R. 849.

37. [1965] 1 Ch 992, pp.1018-19.

38. [1973] 2 NZLR 163.

39. Ibid, 166.

40. [1985] 2 NZLR 41.

41. Ibid, 50.

42. [1986] 2 NZLR 328.

43. [1985] 1 NZLR 83.

44. [1985] 1 NZLR 100.

45. (1991) 1 NZ ConvC 190,917.

46. Evidence received by the Commission during its enquiry into trading in the Five Year Government Stock (No. 2) Futures Contract on the New Zealand Futures and Options Exchange in 1989.

47. Commerce Clearing House, *Guidebook to New Zealand Companies and Securities Law*, Commerce Clearing House New Zealand Limited, Auckland 1990,. p.363.

48. Op Cit.

49. Securities Commission, *Report to the Minister of Justice on Insider Trading*, December 1987, V.1 pp 5-6.

50. Ibid p.95

51. Above No 47, p.363

52. Ibid p.364

53. Above No 49, pp 12 -40

54. Sydney Futures Exchange By-Laws, General By-Law G.10(c).

55. Above No. 6, p.144.

56. Ibid, p.146

57. Op Cit.

58. Ibid, pp.146-147.

59. Ibid, pp.148.

60. Ibid, pp.149.

61. Ibid, p.150.

62. Op Cit.

63. Ibid, p.151.

64. Op Cit.

65. AMEX Commodities Corporation Rule 641(a).

66. Philadelphia Board of Trade Inc, Rule 342(a).

67. Commodity Futures Trading Commission, Federal Register, Vol 55, No. 246, Friday, Dec. 21 1990, p.52294.

68. Above No. 4, p.1047.

69. Ibid, p.1052.

70. Ibid, p.1050.

71. Ibid, p.1053.

72. Ibid, p.1052.

73. Op Cit.

74. Ibid, p.1050.

75. International Organisation of Securities Commissions, Regulation of Derivative Markets, Products and Financial Intermediaries: Collated Responses To Common Framework of Analysis and Cross Regulatory Summary Chart, p.187

76. Ibid, p.192.