Insider Trading in the Fiji Islands: A Critical Analysis

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Introduction

Companies can provide a façade behind which fraudulent activities can flourish. The corporate structure is a potential vehicle for fraud; for example, they are used to solicit funds from the public, reap speculative profits by manipulating the value of their issued securities, or to purchase goods and services when they are insolvent. Companies can be used as a smokescreen behind which the dishonest are easily able to shelter. Equally the company can be a victim of fraud. 1

Criminal law can be used to serve a number of purposes in the sphere of commercial and business fraud. It is most frequently employed as an administrative adjunct in the field of business regulation.

Great many offences whose object is to protect investors and creditors are effected by regulating transactions in shares. Most of these offences are relatively minor. There are also, however, a number of offences that are aimed at preventing market rigging and other practices that have the effect of creating false markets in shares, and otherwise undermining the confidence that investors are entitled to have in the integrity of the markets which they trade. 2

Principal among these fraudulent white-collar crimes is insider trading. Insider trading was initially the subject of self-regulatory rules only, and was viewed by many that worked in the markets to be a perfectly acceptable financial activity. Gradually the perception of the seriousness of the potential damage inflicted by such conduct began to change, and the need for criminal sanctions to reinforce the codes was accepted as being necessary. 3

Although illegal, insider trading is increasing all the time. An "inside trade" occurs when someone misuses confidential information, not available to the public, to make a trading profit. Such information usually involves pending mergers and acquisitions, which are supposed to be kept secret from the public until deals are agreed on. While negotiations take place, those involved are not supposed to use their inside information to their advantage. 4

Professionals are worried about the eroding standards of trust and honesty, but they recognize the pervasiveness of insider trading. And they point out that its not always easy to prove that insider trading has occurred, making the temptations greater. Some argue, in fact, that insider trading should be legal, because confidential information would find its way to the public, and the stock market more quickly. 5

This paper makes an attempt to explore a relatively new criminal offence in the South Pacific, a current and emerging issue of which so far only Fiji has criminalised. Other South Pacific countries should take the same approach, that is, they should also take stricter steps towards eliminating such offences. It would also be of benefit to the other South Pacific jurisdiction considering the emerging Pacific financial markets.

Regulating The Capital Market of Fiji

Due to the nature of the offence and its consequences, is important to regulate the types of transactions that are carried out in the normal course of business in a Pacific country like Fiji. It is interesting to note that in the South Pacific there is only one Stock Exchange and it is located in Fiji. The name has now changed to the South Pacific Stock Exchange, which was established by virtue of the Capital Markets Development Authority (CMDA) Act of 1996. The main objectives of the Act are to develop and regulate the capital market.

Capital Markets are markets for medium to long term investments, i.e. 3 years and over, in securities6, as distinct from the (shorter-term) money market. A well-developed capital market is important to the economic development process of Fiji because it directly affects the two major economic development goals, mainly the mobilization of savings, and the channeling of investment into productive enterprises. 7

The Capital Markets Development Authority Act 1996 establishes the Capital Markets Development Authority. The CMDA Act outlines the functions and powers of the CMDA. One of the functions among others as stated in Section 14 is *"to regulate and oversee the issue and subsequent trading both in primary and secondary markets of capital instruments."*

Provisions to regulate dealings in a company's shares emerged because of widespread concern about the misuse of confidential information by officers of the company, in particular, and also by their associates, their families and friends to whom information about the company had been relayed by them. Regulation has also purported to prevent the misuse by others outside the company such as accountants, auditors and bankers who might equally have access to restricted information about the company which would affect the value of its shares on the market.

Insider dealing occurs where an individual or organization buys or sells securities while knowingly in possession of some piece of confidential information which is not generally available and which is likely, if made available to the general public, to materially affect the price of the securities. 8 The moral or ethical reasons for prohibiting such activities are that the use of insider information is clearly unfair to those who deal with the insider.

One of the difficulties, however, is that in many cases it is seen as a victimless crime in that it is difficult to identify those who have lost by the insider dealing where, as the law currently requires, it takes place on a stock exchange dealing. 9 A more significant reason for attempting to regulate insider trading by law is that the insider with access to confidential information is thereby in a potential conflict-of-interest situation. Probably the primary justification for proscribing insider trading is that it is unethical: "it is contrary to good business ethics that a man holding a position of trust in a company should use confidential information for his personal benefit..."10

Accordingly, any regulation designed to curb insider trading will have as its primary objective the deprivation of any personal benefit accruing to an insider. The subsidiary objective would be of guaranteeing fairness between the insider and those with whom they deal by compensating the latter for any loss attributable to the informational disparity between the parties. 11

Furthermore, such unethical conduct is likely to bring not only the reputation of the company concerned but also that of the securities market in Fiji, or in any other country, into disrepute with the possible risk of a consequent adverse investment effect. One of the problems with policing insider trading is that such transactions often fall into a large gray area, which might or might not be legal.

Insider Trading - The Concept and Operation

Who Is An Insider?

A true insider possess unpublished price-sensitive information in relation to securities of a company, which she or he holds by virtue of being connected with that company. An insider is any person who is directly connected with the body corporate. The CMDA Act provides a definition of the insider:

Section 59 (8) provides that "*a person is connected with a body corporate if, being a natural person -*

(a) he is an officer of that body corporate or of a related body corporate;

(b) he is a substantial shareholder in that body corporate or in a related body corporate; or

(c) he occupies a position that may reasonably be expected to give him access to information of a kind to which subsection (1) apply by virtue of -

> *(i) any profession or business relationship existing between himself (or his employer or a body corporate of which he is an officer) and that body corporate or a related body corporate; or*
> *(ii) his being an officer of a substantial shareholder in that body corporate or in a related body corporate."*

The concept of insider trading and its definition is no easy task. There are two approaches to the definition of insider trading as described by Professor Hogan. 12 The first approach may be viewed as reflecting property rights in information, and rests upon the existence of fiduciary relationships. Thus it advocates that the shareholders have a property interest in the information held by the company.

Under this approach, insider trading is defined as the use of information not publicly available, by a participant in a securities transaction whose access to that information is derived directly or indirectly from a fiduciary relationship which gives the participant or associate a financial advantage over others. The financial advantage mentioned may be secured from trading in securities of the company in which the fiduciary relationship is established or in other companies whose market values may be influenced if confidential information held by the initial company is acted upon. In this latter case this is most commonly expressed in mergers and takeovers.

The second approach, which Professor Hogan describes, emphasizes equality of access to information about a company by all participants in a securities market and sets aside the property concept. With this approach the definition of insider trading is the use of information, not publicly available, by any participant in a securities transaction to the financial advantage over other participants. It is submitted that in Fiji although the former approach described by Professor Hogan is reflected in the elements of the offence of insider trading, the legislature have also seen it fit to incorporate features of the second approach as regards the disclosure requirements imposed on listed companies. In essence the Law in Fiji relating to insider trading encapsulates both definitive approaches by different methods but having the same aim. The aim is to ensure a transparent and equitable market, relatively free of any misuse of price sensitive information.

It must be stressed that this whole notion of making insider trading an offence stems from the well known company law principle that directors owe a fiduciary duty to the company not to make a secret profit and further, the equitable notion that a director must not be allowed to put him/herself in a position in which his/her fiduciary duty and personal interests conflict. It is submitted that there is also an ethical duty for insiders to observe high standards of commercial honor. This in turn would create confidence in the securities market thus leading to the development of the South Pacific's only stock exchange and also gain repute as an exotic world class immerging stock market thus creating the potential for increased foreign

investment.

It has also be defined as "trading in securities whilst in possession of price-sensitive information which is not available to the person with whom one is contracting in face-to-face transaction or to other participants in the securities market at the relevant time." 13 The information may be used by the person who has it, to buy securities at their current price before the material information in question becomes public and causes the price to rise or to sell securities at their current price before their value falls upon the publication of that material information. The offence can only take place when the dealing occurs on a regulated market, or when a professional intermediary is employed, either as an agent or as a principal in his or her own right.

The underlying idea is that the law should extend to all those securities that can be traded on the regulated markets, which are identified by the Capital Markets Development Authority. Securities under the Act includes, debentures, stocks and shares in a public company or corporation, or bonds, bills, tradable promissory notes or drafts of any government or of any body, corporate, and includes any right or option in respect thereof and any interest in unit trust scheme. 14

Purely private deals may at first seem to be excluded from detection and prosecution. This appears to mean that a private individual or a private company who has inside information is able to deal with another private individual or a private company who lacks information without committing an offence under the Act. However as has been stated earlier to ensure transparency it is a strict requirement under the CMDA Act and regulations that all transactions, dealing or trading in any listed security shall be done on the securities exchange. This means that all trades must be done on the Stock exchange.

The CMDA regulations do provide grounds upon which shares could be traded "Off-Market" as private transactions but this has to have the approval of both the CMDA and the South Pacific Stock Exchange. It may be noted that there have to be very exceptional circumstances for the authorities concerned to approve such "Off-Market" transactions.

Insider Trading and the Companies Act of Fiji

It may be noted that only persons trading in securities of listed companies are subject to the insider trading sanctions of the CMDA legislation. The acts of private individuals and/or private companies in securities not listed on the Stock Exchange are regulated by the Companies Act of Fiji. Where such transaction occurs, the people involved may be liable for breach of their fiduciary duties or breach of trust.

This is stipulated in Section 403 of the Companies Act. 15 This section seems to provide a defense where such a breach occurs.

It provides:

"403. If, in any proceeding for... breach of duty or breach of trust against an officer of a company or a person employed by a company... it appears to the court hearing the case that that officer or person is or may be liable in respect of the...breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the...breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as the court may think fit."

This section in the Companies Act of Fiji can be seen in relation to the concept of insider dealing. It provides a defence for the officers or persons connected with a corporate who breach their fiduciary duties. When a person engages in insider trading, that person breaches the fiduciary duty that is owed to the company he or she is working for, thus this provision of the Companies Act can be applied to

situations where insider trading occurs.

Insider dealing is a form of wrongdoing akin to breach of fiduciary duty, since an insider takes advantage of price-sensitive non-public information acquired in connection with his or her office. One this view, a person who receives information from a corporate insider should be prohibited from trading because the information is tainted by its source. However, as has been seen the Companies act does not regulate third parties but only the officers and the employees of the company. The underlying idea seems to be that those who trade on securities markets should have equality of access to information and conversely, a person who has an informational advantage should not be allowed to exploit it by trading. 16

The Offence of Insider Trading in Fiji - The Capital Markets Development Authority Act 1996

Certain dealings are prohibited under Part X of the Capital Markets Development Authority Act. Insider trading is one such act, which is prohibited under the Act. 17 The Act deals with the regulatory controls that exist in relation to insider trading. The Act creates four offences of insider trading, and prescribes certain civil and criminal penalties on the person who is convicted for the offence of insider trading. The four different offences are as follows:

(1) It is an offence for an individual who has information, as an insider that would likely materially to affect the price of those securities, to ***deal*** on a regulated market or through or as a professional intermediary in securities whose price would be affected if the inside information were made public.

(2) It is also an offence for third parties to ***obtain*** material information, directly or indirectly, from another person who he or she is ***associated*** with or has an arrangement for the communication of the information with a view of dealing with securities. The third party must be reasonably aware of the facts and the circumstances that the other person is ***prohibited*** from dealing in those securities.

(3) It is also an offence to ***cause or procure*** another to deal in price-affected securities.

(4) And finally the offence is committed by a person ***communicating*** inside information to any other person. 18

The *Actus Reus* of Insider Dealing

The offences defined

Section 59 of the Act stipulates as follows:

*"59.(1) A person who is, or at any time connected with a body corporate shall not **deal** in any securities of any body corporate if by reason of his so being, or having been, connected with the first mentioned body corporate he is in possession of information that-*

> *(a) is not generally available but, if it were, would be likely materially to affect the price of those securities; and*
> *(b) relate to any transaction (actual or expected) involving both bodies corporate or involving one of them and securities of the other."*

This section provides that a person who is connected with the body corporate should not personally deal in any securities transaction using the information available to him or her, which is not generally available and which would be likely materially affect the price of those securities.

Subsection (2) of the same states in detail the circumstances in which the offence of insider trading can be committed. It states that:

*"59.(2)Where a person is in possession of any such information as is mentioned in subsection (1) that if generally available would be likely materially to affect the price of securities but is not precluded by either of those subsections from dealing in those securities, he shall not **deal** in those securities if -*

> *(a) he has obtained the information, directly or indirectly, from another person and is aware, or ought reasonably to be aware, of facts or circumstances by virtue of which that other person is himself precluded by subsection (1) from dealing in those securities; and*
> *(b) When the information was so obtained. He was associated with that other person or had with him an arrangement for the communication of information of a ki8nd to which those subsections apply with a view to dealing in securities by himself and that other person or either of them."*

This subsection applies to the third parties who are in no way connected to the body corporate but who have access to the material information obtained directly or indirectly, through association and communication arrangement with another person. The third party must be reasonably aware of the facts and circumstances that, that person is prohibited himself or herself from dealing in those securities. It must be proved that the third party obtained the material, price-sensitive information with a view to deal in securities by himself/herself and that other person or either of them.

Thus a person who has such information cannot deal in any securities, regardless of the manner in which he or she has acquired that information.

Subsection (3) further provides that:

*"59(3) A person shall not, at any time when he is precluded by subsection (1), or (2) from dealing in any securities, **cause or procure** any other person to deal in those securities."*

This subsection prohibits a person connected to the body corporate from encouraging or procuring other people to use the confidential information to deal in the securities transaction, where that person is himself or herself prohibited form doing the same.

In addition subsection (4) provides that:

*"59(4) A person shall not, at any time when he is precluded by subsection (1), or (2) from dealing in any securities by reason of his being in possession of any information, **communicate** that information to any other person if -*

> *(a) Trading in those securities is permitted on any securities exchange: and*
> *(b) He knows, or has reason to believe, that the other person will make use of the information for the purpose of dealing or causing or procuring another person to deal in those securities."*

This subsection prohibits the insider from communicating the material information, which has not been published and is generally not available to other people who may then use that confidential information to deal in securities transaction.

Section 59, subsections (1), (2), (3) and (4) prohibit a person who has confidential information from personally or directly dealing with any securities; prohibits third parties from obtaining information and dealing in the securities; encouraging or procuring other people from dealing in securities and finally communicating such information to others so that they may deal in such securities. If a person does any of the above, he or she may, if convicted be liable for the offence of insider dealing under the Act.

The *Mens Rea* for Insider Trading

The mental element of the offence of insider trading is very complex. It is stipulated that ***knowledge*** is the most important element. The knowledge that one is an insider and the knowledge that the information is an inside information. The law would seem to require that the information should relate to particular securities or a particular issuer of securities or particular issue of securities but not to securities generally. It also requires that the information is precise or specific, has not been made public, and if made public would be likely to have a significant effect on the price of ant securities. The requirements of specificity and precision are included to exclude rumor from the ambit of information. Even so, the nature of the information that might count as "inside information" itself remains vague and imprecise.

Penalties Attached to the Offence of Insider Trading

The penalties attached to the offence of insider trading are provided under section 59 (11) of the CMDA Act. These include both civil and criminal liabilities.

It provides, in effect, that if a person contravenes the above section shall be guilty of an offence and shall be liable, upon conviction to -

(a) the consideration for securities; or

(b) three times the amount of gain made or the loss avoided by the insider in buying or selling the securities, whichever is greater; and in addition -

(c) in the case of a person being a body corporate, to a fine not exceeding $20,000; in the case of any other person, including a director and officer of a body corporate, to a fine not exceeding $10,000 or to a term of imprisonment not exceeding 5 years or both.

Section 64 of the same Act provides that any person guilty of the offence of insider trading shall be liable to pay compensation to any person, who entered into a securities transaction with the offender or with a person acting on behalf of that person and suffered a loss, by reason of the difference between the price at which securities were transacted and the price at which they would likely have occurred if the offence had not been committed.

The amount of compensation for which the person is liable under the above section is the amount of the loss sustained by the person claiming compensation. Where the harm has been done on the market as a whole, the liability shall be the amount of the illegal gains received or the loss averted as a result of the illegal action, as determined by the court.

This is an offence where the victims are not readily identifiable, in such cases where those harmed cannot reasonably and practicably be determined, payments mentioned above shall be made to the Investor Compensation Fund, which has been established under the CMDA Act. Section 59 (12) places a time limit of 7 years for the recovery of a loss. It stipulates that an action for the recovery of a loss shall not be commenced after the expiration of 7 years after the date of completion of the transaction in which the loss occurred.

Once it is brought to the notice of the stock exchange that insider trading has occurred, prosecution can be instituted and the recovery of any losses is initiated by the stock exchange. However, it is noted that no prosecution for any offence under the CMDA Act can be instituted except with the consent in writing of the Director of Public Prosecutions. In addition any officer of the Authority authorised in writing by the Chairperson can conduct any prosecution of any offence under the Act. 19 There are other legal disqualifications if a person or a company is convicted of insider trading.

If it is found that insider trading has occurred, the CMDA has powers in:

refusing to grant a licence;
• imposing limitations or restrictions on a licence;
• canceling or suspending a licence;
• refusing to admit a security tot he official list of securities exchange;
• suspending trading of a security on a securities exchange; or
• requiring the removal of a security from the official list of a securities exchange. [20]

Enforcement And Investigation

The Investigation of the offence of insider trading is encapsulated in Part IX of the CMDA Act. Section 55 empowers the Capital Markets Development Authority to appoint investigating officers to carry out investigation of any offence under the Act.

The Powers of the investigating officers appointed by the CMDA are stipulated in sections 56 to 58, which may be summarized as follows:

(a) Authority to enter any place or building or by force if necessary upon production of a search warrant issued by a judge;

(b) Inspect and make copies of any book, minute book, register or document;

(c) Make an Application to the High Court for a warrant to search, seize, take possession of, and detain any object, article, material, thing, accounts, book including any travel or personal document which may be used as evidence;

It is to be noted that failure to comply with the investigating officers directives as regards production of documents or the obstruction of their exercising the powers aforementioned, persons found guilty would be liable upon conviction to a fine of $5,000 or imprisonment for a term of 3 years or both.

(d) May grant permission to any person (third party) to inspect any account, book or document seized and taken into possession of by the investigating officer;

(e) May by way of notice compel any person acquainted with the facts or circumstances of the case to appear before them to be examined orally upon which the statements so made are reduced to writing and the statement may be signed by the compelled party. It is interesting to note that the CMDA Act specifically states that any statement made and recorded are admissible as evidence in any proceedings in any court.

(f) It can also be noted that it is an offence for a person who fails to appear at the oral hearing or furnishes misleading or false information to the investigating officers. Such persons would if found guilty be liable to a fine of up to $5,000 or to imprisonment for a term of up to 3 ½ years or both.

Since no one has been charged yet for an offence of insider trading it is interesting to ponder upon whether such persons would be able to exercise their right to silence to prevent self incrimination if that be the case and also whether the person so compelled has a right to legal counsel present at this investigation stage. It is submitted that the Judges Rules should be used as a guide to the Investigating officers when exercising their powers under this provision to ensure transparency and fairness.

However, as has been seen a person accused of insider trading is subject to a markedly different investigative regime to that accused of almost every other type of criminal offence. The CMDA Act specifically removes the right of silence in insider trading. [21] It is suggested that due to the secretive nature of most insider trading activity, the normal due process investigative model in Fiji would be

ineffective as regards obtaining evidence required to bring a successful prosecution.

The Securities Exchange, that is, the South Pacific Stock Exchange (SPX) (formally the Suva Stock Exchange - SSE) is also empowered under the CMDA Act to make rules for the conduct of its business. There are two main set of rules which regulate the operations of the Securities Exchange, they are the "**Listing Rules**" which regulate the affairs of listed companies and the "**Business Rules**" which inter alia, regulate the affairs of the Exchanges members who are basically stock brokers, dealers and investment advisors. The South Pacific Stock Exchange **Business Rules** requires its members to keep all its financial and customer records, customer agreements; investment advice records; customer history, personnel records of all employees; and all correspondence for a period of seven years.

The South Pacific Stock Exchange, like the Capital Markets Development Authority has under its business rules the powers to inspect, or appoint an agent to inspect, the records of the member. The SPX also has unrestricted access, with or without notice, to members' premises and records, to review compliance with The CMDA Act and the rules and to investigate suspected breaches of The CMDA Act and the rules.

The South Pacific Stock Exchanges **Listing Rules** require stringent disclosure requirements by listed companies, these are contained in the section entitled "Continuing Listing Requirements". The provisions in these rules ensure or at least seek to ensure that information that would materially affect the price of securities is disclosed to the Exchange promptly even before a public announcement is made to shareholders.

As regards mergers, takeovers, acquisitions and dividend declarations be it interim or final, this information has to be disclosed to the Exchange no sooner after a board meeting is convened to consider the issue whether or not the merger, take-over, acquisition, or dividend declaration does in fact materialize. It may also be noted that there is an automatic investigation conducted by the Exchange when there is a price change of + or - 5% in securities of a listed company. This among other uses would be an indicator of possible insider trading.

This indirectly assists the Exchange and the CMDA in its continual market surveillance, thus enabling detection of the misuse of inside information by insiders or their cohorts for financial gain. It may be noted that non-compliance with the continuing listing requirements of the Exchange imposes rather punitive fines and other disciplinary recourses. In all, the investigative machinery of the Capital Markets in Fiji as regards insider trading is explicit, however the detection of the same is rather dependent on external factors such as abnormal price changes in securities.

It is important to note that as provided by section 73, the CMDA Act is paramount if in conflict with any other law or Act and this includes the Companies Act. If for example insider trading has occurred within the CMDA Act, the defendant cannot rely on section 403 of the Companies Act and use it as a defence. He or she will not be allowed to say that the price sensitive information was passed to another person or used to trade in securities, and whatever was done was done honestly and reasonably. They will not be permitted to fall back on the Companies Act. It is thus submitted that the defence of Section 403 if the Companies Act of Fiji regarding breach of fiduciary duty and trust cannot be used as a defence in an insider trading prosecution.

Observations and Conclusion

As has been discussed, the crime of insider trading only applies to insiders who trade in securities that are listed on a securities exchange. Thus, insider trading concerning the securities of unlisted companies would still be governed to some extent by the Companies Act of Fiji. The background upon which the offence of insider trading operates has been described, that is the capital markets and the stock exchange. The concept of the offence and its operation has also been outlined and the elements of the offence

described and analysed. It was noted that there are basically four heads or actus reus upon which the offence can be prosecuted, that is, dealing by any person connected with a body corporate, third parties who obtain price sensitive information, causing or procuring another to deal in securities, and finally the communication by an insider to an outsider of material information. The mens rea was generally that of knowledge, whether actual or implied, that one is an insider and that the information concerned was price sensitive.

The investigation and enforcement of the offence has also been discussed and it was noted that the investigation of the offence was substantially different from that of other criminal offences as the due process right to silence is specifically abrogated by the CMDA Act. That is, persons suspected are compellable during the investigation stage to appear for an oral hearing or inquiry and statements elucidated from this hearing is admissible in court as evidence.

The other significant factor was the "off-market" private transactions in listed securities are prohibited save for exceptional circumstances. Aside from the provisions stipulated in the CMDA Act for investigation by investigating officers with their various powers, it was also noted that the securities exchange has provisions in its business rules and to some extent under its listing rules, the power to enter premises and investigate any suspected breaches of the Act.

In all, the legislative provisions relating to the offence of insider trading and its investigation is rather wide and theoretically ineffective. To date there has been no prosecution brought in Fiji as regards the offence. However, given the particularities of a small island country like Fiji with its intricate and diverse networks it would not be an overstatement to suggest that there have already been instances of insider trades. It may be noted further that the use of a corporate entity to carry out such activities would be the most ideal façade behind which insiders could deal, procure, or communicate such price sensitive non-public, material information for financial gain or to reduce financial loss in the Capital Markets of Fiji.

It is envisaged that with awareness of the criminal offence of insider trading and the continued market surveillance conducted by both the CMDA and the Stock Exchange in Fiji, such activities would be minimal. It was also noted that the penalty imposed by the law was two fold, that is, there is a criminal offence upon which a substantial fine or imprisonment is prescribed and there is also the civil remedy available to compensate the victim of the crime three times the gain procured. It is submitted that the legislation, criminalising insider trading in Fiji is robust.

There are however, practical implementation problems. So far in Fiji there has not been a single reported case to come under the Act. That is to say that there has not been any successful prosecution of insider trading under the CMDA Act, and to think that insider trading is not occurring in Fiji would be cynical. In conclusion, it is submitted that the strict investigation and enforcement of this crime would ensure not only an open and transparent and equitable Capital Market in Fiji, but it would be a deterrent to insiders who wish to breach their position of trust and fiduciary duty thus paving the way for a high standard of ethical business practice in the securities market.

REGULATION OF INSIDER TRADING IN AUSTRALIA

Introduction

Insider trading has been the subject of concern in Australia for at least the past 20 years. There have been a large number of responses from the officials, resulting from the booming market conditions. However, none of these responses to insider trading have significantly affected the activity of insider trading or led to more efficient law enforcement procedures.

The extent of insider trading in Australia was highlighted in the 1974 report of Australian Securities

Markets and their Regulation and the Senate Select Committee on Securities and Exchange (the Rae Committee) During the 1980's the Australian community and the officials renewed their concerns about insider trading. One of the major reasons was the perceived, undesirable impact that the widespread presence of insider trading had upon the international reputation of Australian securities markets.

In October 1987, the Australian markets crashed. The Federal Attorney General in February 1989 requested the House of Representatives Standing Committee on Legal and Constitutional Affairs (the Griffith Committee) to conduct an inquiry into insider trading and other forms of market manipulation. After 8 months the report was tabled and it confirmed the widespread nature of insider trading and a call for legislative reform was made. [22]

In Australia there existed a legislation regulating insider trading, this was the Securities Industry Act 1970 (N.S.W.) which was later replaced by the Securities Industry Act 1980. In the 1970 Act, it was section 75A, which covered insider trading, and in the 1980 Act it was replaced by section 128. This was later succeeded by section 1002 of the Corporations Law. After the release of the reports in 1990 the Government endorsed the recommendations made by the Committee. In the same year the Federal Attorney General released an Exposure Draft of the proposed new insider trading legislation. In the draft it was proposed that section 1002 be repealed and replaced by 12 new sections which would be more effective then section 1002.

In Australia there have been several cases [23], which came before the courts where charges were laid under the existing legislation. Despite the finding that insider trading had occurred, it was difficult to justify those findings. These cases illustrated the perversity of this body of law and the also the inability of the courts to function as vehicles of law reform in this area. [24]

Insider Trading - The Concept, Offence and Operation in Australia

Who is an Insider?

Section 1002G (1) of the Act stipulates that:

"(a) An insider is a person who possesses information that is not general available but, if the information were available, a reasonable person would expect it to have a material effect on the price or value of securities of a body corporate; and

(b) The person knows, or ought reasonably to know, that;

> (i) the information is not generally available; and
> (ii) if it were generally available, it might have a material effect on the price or value of those securities;

The following subsections apply."

This sub-section defines who an insider is, and such a person is one who has information which is not generally available and if it were made available would have a material effect on the price or value of the securities of a body corporate.

Under the Fiji Act an insider is a person who is connected with a body corporate and in that capacity has acquired information which is not generally available. The person has to be directly connected to the body corporate to come under the ambit of the Act. Whereas in Australia the person need not be directly connected to the company as long as he or she possess the information which is likely to have a material effect on the securities in the market.

Sub section 2 contains the elements of the prohibited conduct and stipulates that:

"The insider must not:

> (a) Subscribe for, purchase or sell, or enter into an agreement to subscribe for, purchase or sell, any such securities; or
> (b) Procure another person to subscribe for, purchase or sell, or to enter into an agreement to subscribe for, purchase or sell, any such securities".

This provision is similar to the one if Fiji in that the insider is prohibited from dealing personally in securities using the price sensitive information and also prohibited from influencing third parties to deal, purchase or sell or enter into agreements and using the information for their benefit.

Furthermore, subsection 3 provides that:

"Where trading in the securities referred to in subsection (1) is permitted on the stock market of a securities exchange, the insider must not, directly or indirectly, communicate the information, or cause the information to be communicated, to another person if the insider knows, or ought reasonably to know, that the other person would or would be likely to:

> *(a) Subscribe for, purchase or sell, or enter into an agreement to subscribe for purchase or sell, any such securities; or*
> *(b) Procure a third person to subscribe for, purchase or sell, or enter into an agreement to subscribe for, purchase or sell, any such securities."*

The insider must not communicate the price sensitive information, which she or he has acquired during the course of business, either directly or indirectly to another person if she or he knows that the other person is likely to use the information to buy, sell or subscribe for any such securities.

In her paper on insider trading, the Commonwealth Director for Public prosecutions summarised the elements of the offence of insider trading under section 1002G can be summarised as:

(i) A person possesses information

(ii) That is not generally available

(iii) If the information were generally available, a reasonable person would expect it to have a material effect on the price or value of securities of a body corporate

(iv) The effect will be material if the information would or would be likely to influence persons who commonly invest in securities in deciding whether to buy, sell or subscribe for the first-mentioned securities

(v) The person in possession of the information knows or ought reasonably to know that the information is not generally available, it might have a material effect on the price of those securities

(vi) The effect will be material if the information would, or would be likely to, influence a person who commonly invests in securities in deciding whether to buy, sell or subscribe for the securities

(vii) The person buys, sells or subscribes for any such securities. [25]

It seems that under the Australia Act, it is not necessary to prove that the defendant used the information to trade. It is only necessary to prove that he or she was in possession of such price sensitive information

and did in fact trade on the basis of that information. [26]

In her paper she outlined the things that the prosecution has to prove in insider trading prosecutions. In relation to the information it has to be proved that the information was inside. It must be shown that the information was not generally available and that a reasonable person (the investor) would expect it to have an effect on the price or value of the shares. In addition to that it has to be shown that the effect would be material, that is the information would or would be likely to influence a person who commonly invests in securities in deciding whether to buy or sell the shares.

It is submitted that under the Australian Corporations Law, it is not necessary to prove that the defendant used the information to trade. It would be sufficient to prove that the defendant was in possession of such price sensitive, inside information and did in fact trade.

According to the Commonwealth Director of Public Prosecutions in Australia, Ms. June Phillips it was stated that the prosecution, to establish an offence of insider trading under the Act had to prove the following:

The Actus Reus

In relation to the information, it has to be proved that the information was inside information. It must be shown that the information was not generally available and that a reasonable person (the investor) would expect it to have an effect on the price or value of the shares.

In addition to that it has to be shown that the information would or would be likely to, influence a person who commonly invests in securities in deciding whether to buy or sell the shares. [27]

The Mens Rea

To prove the mental element of the offence, the prosecution has to prove that the defendant knew or ought reasonably to now that:

(a) The information is not generally available,

(b) That the information might have an effect on the price or the value of the shares, and

(c) That a person who commonly deals in securities might be influenced by the information in deciding whether to buy the shares and/or convertible notes. [28]

Penalties and Enforcement

Actions nay be brought against the insider who subscribed for or opted to subscribe for securities or who sold securities as well as "any person involved" in the contravention. Action may also be brought to recover the loss suffered by the buyer or by the seller of securities or by the corporation that issued the securities which were subscribed for, or agreed to be subscribed. [29]

In insider trading cases the courts in Australia have certain powers which are prescribed under the Act. Where in a proceeding instituted under this Law, the court finds that a contravention of section 1002G has occurred, the court may, in addition to any other orders that it may make under any other provision of this Law, make such order or orders a it thinks just, including, but without limited the generality of the above, any one or more of the following orders:

(a) an order restraining the exercise of any voting or other rights attached to shares;

(b) an order restraining the exercise of any rights attached to securities other than shares;

(c) an order restraining the issue or allotment of shares;

(d) an order restraining the issue or allotment of securities;

(e) an order restraining the acquisition or disposal of securities;

(f) an order directing the disposal of securities;

(g) an order vesting securities in the Commission;

(h) an order canceling an agreement for the acquisition or disposal of securities;

(i) an order canceling a securities licence;

(j) for the purpose of securing compliance with any other order made under this section, an order directing a person to do or refrain from doing a specified act. 30

When compared to the powers vested in the courts in Fiji, the courts in Australia have more powers in relation to the offence of insider trading. In Fiji it is the CMDA which conducts investigations and deals with the offenders, whereas in Australia the courts seem to have more power in regard to insider trading offences.

It is submitted that the laws regarding insider trading offences be hardened in order to remove any loopholes using which the offenders may escape liability for the offence. This will then ensure that it is easier for the prosecution to bring successful prosecutions against insider traders.

Endnotes

[20] Section 65, Capital Markets Development Authority Act, 1996.

[22] Tomasic R, 1991, Insider Trading Law Reform in Australia, Company And Securities Law Journal, Volume 9, June 1991, Number 3, The Law Book Company Limited, p.121.

[23] Meyers v Cladicinos (1990) 2 A.C.S. R, 73; Keygrowth Ltd. V Gregory Mitchell and Ors and the NSSC (1991) 3 A.C.S.R 476; Waldron v Green (1978) 3 A.C.L.R 28; Mallesons Stephen James v KPMG Peat Marwick and Ors, Unreported, Supreme Court, W.A, Ipp. J., 19 October 1990; D & J Constructions Pty Ltd. V Head and Ors (1987) 9 N.S.W.R 118.

[24] Tomasic R, 1991, Insider Trading Law Reform in Australia, Company And Securities Law Journal, Volume 9, June 1991, Number 3, The Law Book Company Limited, p.121.

[25] June Phillips, Insider Trading, Commonwealth Director of Public Prosecutions, 16/2/95.

[26] Ibid. p., 21

[27] Ibid.

[28] Ibid.

[29] Company Securities Act 1991, Section 1005.

[30] Section 1002U.

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