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Challenges for a Protective Regime: Insider Trading Laws and Regulatory Framework in the Context of the Ethiopian Securities Exchange and the International Experience

BY

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**A THESIS SUBMITTED TO THE SCHOOL OF LAW, COLLEGE OF LAW AND GOVERNANCE
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Declaration

I hereby declare that this thesis titled “*Challenges for a Protective Regime: Insider Trading Laws and Regulatory Framework in the Context of the Ethiopian Securities Exchange and the International Experience*” has been carried out by me under the guidance and supervision of my advisor Professor Tilahun Teshome

The thesis is original and has not been submitted for the award of any degree or diploma to any university or institution.

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<u>Lea Mehari Redae</u>	_____	_____

Certification

This is to certify that Lea Mehari Redae has carried out this research work on the topic “*Challenges for a Protective Regime: Insider Trading Laws and Regulatory Framework in the Context of*

the Ethiopian Securities Exchange and the International Experience” under my supervision. This research is her original work and has not been presented for a degree in any university, and all sources of materials used for the study have been duly acknowledged. Thus, it is sufficient for submission for the partial fulfilment of the requirements for the award of a diploma for Master of Laws.

Advisor: Professor Tilahun Teshome

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Date: _____

Addis Ababa University

College of Law and Governance Studies

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Challenges for a Protective Regime: Insider Trading Laws and Regulatory Framework in the Context of the Ethiopian Securities Exchange and the International Experience

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Abstract

1956 saw the first ever public subscription for shares of an Ethiopian company – Ethiopian Abattoirs. However, almost sixty years later, the work to develop the Ethiopian Securities Exchange is underway, an effort that is long overdue but very much welcome.

This paper examines the risk of insider trading in the Ethiopian Securities Exchange. First, it analyses the core concepts of insider trading in literature and studies the arguments for and against its prohibition. It then studies the prohibition and regulation of insider trading in five jurisdictions around the world, to be used as a doctrinal comparative analysis against which the Ethiopian system will be analyzed. Then it goes to assess insider trading laws in the Capital

Markets Proclamation of Ethiopia and other relevant legislations. The paper then studies the potential challenges that make the regulation of insider trading in Ethiopia difficult and concludes by providing recommended solutions for those challenges.

Regardless of the existence of a structured and organized secondary market, for the past few decades, shares of Ethiopian companies have been bought and sold in an informal securities market. As such, there are several share trading cultures practiced in the Ethiopian market that could potentially increase the risk of insider trading in Ethiopia, such as exaggerating profits and profitability in the prospectus, withholding information, or the communal Ethiopian lifestyle which could allow outsiders easy access to inside information through close-knit relationships. Additionally, the lack of adequate financial literacy and investor education among the population and the weakness of the law enforcement and judiciary when it comes to financial crimes and market abuse would likely exacerbate the risk of insider trading.

The author of this paper has provided six recommendations geared at addressing the concerns of policy makers, companies themselves and the public at large with regards to insider trading, and its prohibition and regulation, in the Ethiopian Securities Exchange, possibly serving the capital market as a whole as well.

List of Abbreviations

BOFIA - Banks and Other Financial Act

CAMA - Companies and Allied Matters Act

CISI – Chartered Institute for Securities and Investment

CMA – Capital Markets Authority

EPRDF - Ethiopian People's Revolutionary Democratic Front

ESX – Ethiopian Securities Exchange

ETB – Ethiopian Birr

FCA – Financial Conduct Authority

FDRE – Federal Democratic Republic of Ethiopia

FINRA - Financial Industry Regulatory Authority

FSA – Financial Services Authority

GDP – Gross Domestic Product

ISA - Investment Securities Act

NLRC - Nigerian Law Reform Commission

NSE – Nairobi Stock Exchange

SEBI - Securities and Exchange Board

SEC - Securities and Exchange Commission

SRO – Self-regulatory Organisations

Chapter 1 - Background

1.1. Background Statement

Ethiopia is now in interesting economic times. The country is anticipating economic changes in the new decade, one of which would be the introduction of a stock exchange. The Office of the Prime Minister had released a one-page prototype suggesting the government's intention to develop the capital market. It was stated in the template that it aims at developing a road map that will introduce trade financing instruments that includes the stock market¹. In 2021 the Capital

¹Kaleyesus Bekele, Addis Ababa Stock Exchange in 2020, The Reporter, 2018, <https://www.thereporterethiopia.com/article/addis-addis-stock-exchange-2020>(last visited April 18, 2020).

Markets Proclamation was enacted. Finally, the process of establishing a stock market in Ethiopia is underway.

This is not going to be the first time that Ethiopia has a stock exchange. The country has had Share Companies as far back as 1942, and in 1956 the first share company, Ethiopian Abattoirs, floated its shares to the public. This company paved a way for other share companies to float their shares to the public as well². The subsequent increase of interest from more share companies to float their shares led to the establishment of a unit within the then State Bank of Ethiopia, tasked with overseeing and regulating share dealings in the country. Thereafter, due to its success, this unit was expanded into a department within the bank with wider mandates; it also saw the increase in the number of participating share companies from five to eleven. In 1965 the Share Dealing Group, comprising six external members, additional to the country's National bank, was formed with more than twenty share companies listed and their shares floated.

The Share Dealing Group maintained its success until 1974 where the popular revolution that led to the coming to power of the Provisional Military Administrative Council (Derg), also brought with it a socialist economic system thwarting the market led economy existing at the time.

In 1991, the Ethiopian People's Revolutionary Democratic Front (EPRDF) took power after defeating the Provisional Military Administrative Council (Derg). With it, the economy was reformed into a regulated market economy. Although the economic reform showed much improvement in the treatment of private companies and privatisation at large, it did not lead to a quick return of a capital market in Ethiopia. During this time, there have been fierce debates on the importance and challenges of establishing a stock market in Ethiopia and even draft legislations under consideration, nevertheless, none bore fruit.

It wasn't until three decades later, in 2021, that there finally were formal moves to establish a capital market in Ethiopia. On June 10, 2021, the House of Peoples' Representatives of the FDRE unanimously approved the draft proclamation and promulgated Proclamation No. 1248/2021 the Capital Markets Proclamation. This proclamation will enable the establishment of a stock market where shares, bonds, equities, and other types of securities will be bought and sold.

²*'Proposal for the Formation of a Share Market in Ethiopia'*, East African Investment Securities P.L.C and Commercial Nominees, Addis Ababa Chamber of Commerce, March 1999, p. 1

A stock market is simply defined as ‘the market for dealing in stocks and shares.’³ A stock market is a well-organised and highly regulated type of financial market where various forms of securities, such as shares/stocks, bonds, and notes are bought and sold at prices that are governed by economic forces. Unfortunately, in Ethiopia, with more than 100 million people and as one of the fastest-growing economies in Africa, has been the most populated country in the world without a stock exchange⁴. This seems to be changing now as Proclamation No. 1248/2021 the Capital Markets Proclamation has been adopted by the House of Peoples’ Representatives providing for the legal framework to establish the long-awaited stock exchange in Ethiopia. Through this proclamation, the Ethiopian Securities Exchange has been established⁵. In addition, the proclamation also provides the legal framework for the establishment of other securities exchanges and trading platforms in the country.⁶A securities exchange under the Ethiopian law has been defined as the premise where the selling, purchasing, or exchanging, or offers or invitations thereof, of securities is made or accepted, where the necessary information regarding those securities is regularly provided, or where securities clearing services are provided.⁷

A well-functioning stock market needs to build the confidence of both sellers and buyers of shares. It should also have the ability to ensure an efficient and legible dealing of shares⁸. But some essential conditions have to be met to have a well-functioning and capable stock market. The market and its members should have strong professional ethics and integrity. Clear requirements and standards should be set on the participation of members in the market for the registered companies, professionals, brokers, and agents. The expected transactional costs and the expenses to be encountered should be reasonable and predictable. There should be monitoring and control over all of the market’s activities. The movement of prices and shares as well as any information that may affect it should be made public regularly. The participants of the market should be treated equally and fairly. And last but not least, the market should have the ability to execute transactions timely and at stated prices⁹.

³ Merriam- Webster’s collegiate dictionary (11th ed.), 2016

⁴Kaleyesus, supra note 1

⁵ Capital Markets Proclamation No. 1248/2021, Art. 31

⁶ Id, Art. 32

⁷ Id, Art. 2(67)

⁸ Proposal. supra note 2

⁹ Id

There have been various arguments both for and against the establishment of a stock market in Ethiopia. Some have argued that many of the companies value the discretion of their business and consider that the requirement of disclosing information will infringe upon their right to privacy.¹⁰ Another argument has been that due to factors such as the bad track record, lack of work ethics, inefficient management, and other similar factors of the public enterprises in Ethiopia, investors will not be in a hurry to buy their shares¹¹.

Those that argue for the establishment of the stock market put forward that a well-functioning stock exchange will open up investment opportunities for the public by mobilising savings. It will also have the power to attract international capital¹². The stock market and its forces will help in disciplining the management of companies. As it pushes for public ownership, it will also increase the accountability and transparency of the businesses¹³. Particularly in Ethiopia, it is believed that establishing a stock market will decrease the concentration of ownership of companies in the hands of the very few. It will also contribute immensely to the economic growth of the country by encouraging investment by enabling traders to buy and sell stocks very easily¹⁴.

The mere existence of a stock market, however, does not promise immediate economic development. The market needs to be adequately regulated in order to ensure that transactions and dealings are fair, effective, and efficient; thereby maintaining the confidence of both buyers and sellers. Some of such things that require regulation in a stock market are various types of financial crimes. Let alone a stock exchange in its infancy such as the Ethiopian Securities Exchange, even the most developed stock exchanges with their strict scrutiny and regulations, are still susceptible to various financial crimes, such as but not limited to, insider trading, market abuse and manipulation, and money laundering.

Some scholars argue that financial markets such as the stock market need to be regulated because they can, by their nature, exhibit failures of the market that are likely to bring about devastating

¹⁰Asamenew Barega, *The Policy, Legal and Institutional Framework for Stock Market Development in Ethiopia*, 2007. p.9

¹¹ Id

¹²Jetu Edossa Chewaka, '*Legal Aspects of Stock Market Development in Ethiopia: Comments on Challenges and Prospects*', *Mizan Law Review*, Vol. 9 No. 2, December 2014, p. 440

¹³ Id

¹⁴ Id

effects on the economy as a whole¹⁵. In countries like the US, the failure of the stock markets has brought about a major decline in the real economy of the country and other countries too. In particular, the financial crisis that was caused by the mortgage market in the US in the 2000s has not only affected the GDP of the US, but it has led to the decrease of the German GDP by six percent¹⁶.

Insider trading is a term commonly used for companies that are publicly traded, what we call share companies formed by public subscription in Ethiopia. Insider trading happens when a person buys or sells the shares of a company based on information that he/she has received that is non-public but is of significant value to the decisions made on the share. Insider trading is an illegal act because the transaction is conducted on information that has not been made public yet.¹⁷ Especially in countries that have a functional stock market, insider trading is a criminal act, punishable by law.

Insider trading has been made illegal for the purposes of maintaining a fair marketplace. Gaining a piece of inside information that has not been made public will give a person an unfair advantage over other parties who are seeking to buy or sell their shares.¹⁸

In India, insider trading is considered as the buying or selling of shares based on secret information of the company. The Securities and Exchange Board (SEBI) of India Act of 1992 provides that insider trading requires an insider, a person that is either working in the company or who has information that is non-public about the company or the share. This information could be financial reports, the decision on dividends, plans for expansion or new projects, corporate reorganisation, or changes in company policy or plans. It should be noted that this information could potentially be made public at a certain point, but due to insider trading, the person has the information before

¹⁵ Id

¹⁶ Id

¹⁷ Insider Trading, Investopedia, <https://www.investopedia.com/terms/i/insidertading.asp> , last accessed on April 19, 2020

¹⁸ Corporate Finance Institute, Insider Trading, <https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/what-is-insider-trading/> , last accessed on April 19, 2020

it is made public. Insider trading occurs when the dealing of shares is made based on that information before it was made public.¹⁹

In the US insider trading is defined as “the buying and selling, in breach of fiduciary duty or other relationship of trust and confidence, based on material, non-public information about the security”. The information that was provided has to be information that would significantly influence the investor’s decision in dealing with stocks. The information has to be information that has not been made public yet.²⁰

In the US, insider trading as a crime carries penalties. The penalties, similar to the case in India, are imprisonment or fine. Sometimes both penalties could be imposed on the same person.²¹

In the case of Ethiopia, one proof of the fact that the company law is still at its infant stage is that, outside of the rules stipulated under the very recently enacted Capital Markets Proclamation, this researcher could not find the civil consequences of insider trading in Ethiopia. This could be because Ethiopia had no stock exchange, and it is in stock exchanges that the issue of insider trading is normally raised.

Before the enactment of the Capital Markets Proclamation, there were no provisions in the criminal code of Ethiopia regarding insider trading as well, although there are other provisions relating to crimes committed in connection with a stock market. The only criminal code provision that can be used to hinder and create consequences on insider trading is Art. 697 of the Criminal Code which states *“Where there is a crime, other than those mentioned above, defined in a proclamation or regulation relating to shares, merchandise, documents, bonds or securities of any kind, the punishment shall, unless otherwise be provided, simple imprisonment, or, in serious cases, rigorous imprisonment not exceeding five years.”*

¹⁹ Legal Services India, Insider Trading Laws in India, <https://www.legalserviceindia.com/article/1421/insider-trading-laws-in-india.html>, last accessed on April 19, 2020

²⁰ *Investopedia*, *supra* note 19

²¹ *Id*

1.2. Statement of the Problem

As discussed above, the mere establishment of a stock market will not instantly provide the aforementioned and other advantages. It is necessary to have a regulatory mechanism in place to control such stock markets and the dealing of shares. Such regulatory mechanisms should be able to protect the consumer and property rights, properly enforce contractual rights and obligations, it should also have the capacity to enforce corporate governance²². The regulation of the stock market will, first and foremost, serve as a bridge for the information asymmetry of the unsophisticated buyers of shares and knowledgeable sellers²³.

To be able to regulate the stock market that has been planned, the Capital Market needs to have an efficient legal and institutional regulatory framework to protect information asymmetry and market abuses, which can lead to insider trading. This research will look at the experiences of other countries in the regulation of Insider Trading in their stock exchanges and take lessons from the comparative exercise. It will also study the insider trading laws under the recently promulgated Capital Markets Proclamation, as well as the regulatory frameworks to regulate insider trading in other laws in Ethiopia. It will study the potential challenges of mitigating insider trading due to the realities of the Ethiopian share trading tradition. While assessing these challenges, the author will recommend potential solutions to mitigating the specific challenges to the prevention of insider trading in Ethiopia.

This paper analyses the need for a strong legal and institutional framework for the prevention of insider trading in the Ethiopian Securities Exchange as well as other securities exchanges and trading platforms that will be established in Ethiopia under the Capital Markets Proclamation.

1.3. Research Questions

Main Question

²²Kiflework Bekele, *'Should Ethiopia Consider Establishing Stock Market?'*, (MBA Thesis), Addis Ababa University, 2018, p. 5

²³ Mark Taylor, *'Why regulate?'*, The Warwick Commission, p. 9

- **What type of legal and regulatory frameworks for the regulation of Insider Trading are needed for the Ethiopian Securities Exchange and other securities exchanges in Ethiopia to function properly?**

Specific research questions

- Does insider trading in securities exchanges in Ethiopia need a legal and regulatory framework?
- What can be learned from the comparative analysis of legal and regulatory frameworks prohibiting and preventing insider trading in various jurisdictions?
- What type of regulation should insider trading in the Ethiopian Capital Market, specifically in the Ethiopian Securities Exchange, be made subject to?

1.4. Research aims and objectives

Research aim: *To assess the necessary legal and institutional frameworks for the regulation of Insider Trading needed for the Ethiopian Capital Market to function properly and provide recommendations on how to best structure them.*

The following research objectives will help facilitate the achievement of the above-stated research aim:

- I. To identify the need for insider trading laws in the Ethiopian Capital Market
- II. To analyse the need for a regulatory framework for insider trading in the Ethiopian Capital Market
- III. To identify the legal as well as regulatory framework within the Capital Market Proclamation and other legislation regulating insider trading in Ethiopia
- IV. To conduct a comparative analysis of the insider trading rules and regulatory frameworks in five countries

1.5. Hypothesis

It is the thesis of the author that the Ethiopian Securities Exchange and other securities exchanges need to have strong and robust legal and regulatory frameworks for the regulation of insider Trading.

1.6. Research Methodology

The research conducted will encompass aspects of a doctrinal research. To serve a comparative purpose, the legal and regulatory frameworks of the regulation of insider trading in countries with the well-established Stock Markets in various regions of the world will be assessed. In Addition to Ethiopia, five countries have been selected for this research. The countries selected are as follows:

<i>No</i>	<i>North America</i>	<i>Europe</i>	<i>Asia</i>	<i>Africa</i>
1	United States of America (US)	United Kingdom (UK)	India	Nigeria
2				Kenya
3				Ethiopia

1.7. Research methods

The doctrinal aspect of the research will be conducted to gain a deeper understanding of the insider trading rules relating to securities exchanges in Ethiopia. These provisions will be used to identify the rules on issuing of Stocks or Shares as well as regulation of insider trading, a legislative analysis will be undertaken on the Capital Markets Proclamation, Commercial Code of Ethiopia, as well as the Criminal Code of the FDRE.

For the comparative analysis, the insider trading legislations of the selected countries and judicial decisions that have been rendered concerning insider trading cases will be studied.

The researcher will also conduct a study into secondary sources that will help analyse and interpret the primary sources that have been stated above, to conduct a research into the usefulness, and enforcement gaps in the insider trading laws in Ethiopia.

1.8. Sampling Techniques

1.8.1. Sampling of the countries that will be used for the comparative analysis

The sampling design used to collect data from the countries to conduct a comparative analysis is the **Purposive/ Judgmental sampling**. This research paper aims to conduct an in-depth analysis of what type of regulatory framework is needed to ensure the Ethiopian Securities Exchange will be able to function properly. Therefore, conducting research into the experience of other countries

is necessary to see what type of regulatory framework could work for Ethiopia. For this reason, the researcher has categorised the countries that have working securities exchanges into regions based on the continent they belong to. From the seven continents, the researcher has decided to study four continents, namely North America, Europe, Asia, and Africa. From these four continents, the researcher has chosen the host countries that have robust insider trading laws and applied them. From North America, the US has been chosen for this study. From Europe, the case of the UK will be studied. The country chosen from Asia is India while from Africa, Nigeria and Kenya have been chosen for comparative analysis for this research.

1.9. Scope of the Study

The scope of this study is limited to examining the insider trading rules and regulatory frameworks of five countries. From North America, Europe and Asia only one country each has been selected, while from the African continent two countries have been selected for this study.

1.10. Limitations of the Study

This research has some potential limitations. The first is the availability of only a limited time to conduct the overall research. As such, it would not be possible to conduct research into the legal and regulatory frameworks prohibiting and preventing insider trading in more jurisdictions. However, this researcher has attempted to examine the experiences in 4 different continents to ensure diversity.

Second, the countries selected for the comparative analysis (US, UK, India, Kenya and Nigeria) follow the common law legal system, while Ethiopia follows a mix between the common law and civil law legal traditions. However, much of the jurisprudence on insider trading comes from the US, and therefore, it is impossible to ignore it. For the jurisprudence on insider trading from Europe, Asia and Africa the breadth of the jurisprudence are prepared in non-English languages making it difficult for the author to collect and analyse materials from other countries (for e.g. France, Germany, Hong Kong/China, Tokyo etc).

Third is the absence of previous literature on the topic of insider trading in the context of the Ethiopian securities exchange, or the Ethiopian financial market in general. Therefore, the researcher had to conduct the research from scratch. The author suggests further development in the area of the study to identify the literature or practice gaps that may exist.

Chapter 2 - The Concept of Insider Trading

2.1. Core Concepts

Insider trading cases are highly publicised, often damaging the public image of the participants. Since Ivan Boesky's famous cases in the 1980s²⁴ and of Martha Stewart in the early 2000s²⁵, insider trading cases, when they have gone to trial have made headlines. Insider trading is thought to be at the core of inequality because it offers an unfair competitive advantage to a select, and fairly well-off minority over a vast majority who may not receive the same information or opportunity. The use of privileged information for the aim of obtaining gains or preventing losses, at the detriment of others, is morally and legally wrong. Its prohibition is therefore necessary for the smooth functioning and integrity of the financial sector and of the participants of the markets.²⁶

Nevertheless, not all cases of insider trading are illegal. There is legal and illegal insider trading. Because company insiders are legally obliged to disclose all of their dealings, many investors and brokers imitate what insiders do. As a result, various financial experts, that are outsiders, evaluate recent purchases by corporate insiders to identify details on market fluctuations. As a result, outsiders are likely to interpret and make informed decisions.²⁷ This type of insider trading is legal and is rather referred to as “informed trading”.

²⁴Ana Gonzalez Riberio, 'Financial Villains: Where are they Now?' (Investopedia, 25 February 2020)

<<https://www.investopedia.com/financial-edge/0310/financial-villains-where-are-they-now.aspx>> accessed 23 May 2020, Ivan Boesky was one of the most powerful speculators in Wall Street. He faced civil and criminal charges in the 1980's for insider trading and illegally manipulating stock. He had disclosed that once he had paid 700,000\$ for inside information and earned more than 30 Million dollars. He made a deal with the SEC to be a government witness and was sentenced to three years in prison and a one hundred million dollar fine.

²⁵U.S. Securities and Exchange Commission, *SEC Charges Martha Stewart, Broker Peter Bacanovic with Illegal Insider Trading (2003)*, <https://www.sec.gov/news/press/2003-69.htm> (last visited Jul 27, 2020)., Martha Stewart, a business woman and television personality, was convicted of Insider Trading after she sold her stock in a company called ImClone Systems, INC., after receiving illegal insider information on the rejection of the licensing application, from her stockbroker. She used this information to sell all of her 3928 shares before the stock prices went down. Due to a false statement to the SEC, Martha Stewart was found guilty and served five months prison time and another five months of home confinement, additionally she faced a two-year probation from engaging in stock exchange. She also paid a 30,000\$ fine.

²⁶Johannesburg Stock Exchange, *Insider Trading and Other Market Abuses (Including the Effective Management of Price Sensitive Information)*, 2015, p. 4

²⁷Stanislas Nivelteau De La Brunière, Jean-Come Haye & Paolo Mazza, *The Performance Of Corporate Legal Insiders on The French Stock Market*, 61 International Review of Law and Economics 61 (2020), p. 2

The key aspects of illegal insider trading on the other hand are very much similar in many jurisdictions around the world.²⁸ These key aspects are:²⁹

1. engaging in a securities transaction,
2. while in possession of material and non-public information, and
3. in violation of a duty to refrain from doing so.

Illegal insider trading happens when an individual or company transacts in some security based on non-public material information acquired in violation of the obligation of confidence or trust. To be held responsible for insider trading, an individual must also act with a malicious intention.³⁰ This illegal act of insider trading requires the trading of security when in possession of confidential sensitive details regarding the securities issuer and includes similar breaches, such as tipping information and transaction of securities by the individual who is tipped.³¹ The term securities comprises a broad array of various instruments, such as, but not limited to, common and preferred shares, interest certificates, treasury bonds, bonds, or any security privileges.³² An individual is deemed to be transacting based on material, non-public information regarding securities, if the individual knew that the information was vital but not yet public at the time of the transaction of the security. The information is considered to be material if there is a high probability that a reasonable and rational investor would recognize it to be crucial and will take it into account while making an investment decision. It is also deemed to be material if a reasonable and rational investor may find it to have substantially changed the information currently publicly available regarding the financial instruments of the company³³. Therefore, the materiality often depends on

²⁸Arthur Yan, *Insider Dealing Law in Hong Kong* (September 1, 2013). Centre for Financial Regulation and Economic Development Working Paper No. 13, Available at SSRN: <https://ssrn.com/abstract=2322774> or <http://dx.doi.org/10.2139/ssrn.2322774>, p. 11

²⁹Paul J. Foley, Clay C. Wheeler & John I. Sanders, *Supreme Court Confirms Expansive View of Insider Trading* | Lexology.com (2020), <https://www.lexology.com/library/detail.aspx?g=d0a1cd90-7a5a-4aed-bbff-8a244af84411#:~:text=Insider%20Trading%3A%20The%20Tradition&text=The%20basic%20elements%20of%20insider,to%20refrain%20from%20doing%20so> (last visited May 27, 2020).

³⁰Harry S. Davis, *Overview of the Law of Insider Trading, in Insider Trading Law and Compliance* (2017), https://legacy.pli.edu/product_files/Titles/4553/%23172874_Insider%20Trading%20AB%202017_2016100509542_1.pdf (last visited May 27, 2020), p. 2

³¹National Business Law Section Canadian Bar Association, *Illegal Insider Trading in Canada: Recommendations on Prevention, Detection and Deterrence* (2003), p. 3

³² Id

³³ Id

the importance that a reasonable investor will place on the information acquired. The information is deemed to be non-public if it has not been widely circulated to market investors. Clear evidence of distribution is the strongest indicator that information has been made available. The goal is to make the information accessible to the consumer to a point where it can be observed in the price of the security in the market.³⁴

The concept of insider trading has been researched for a long time, but still, it poses problems for both scholars and authorities. Assessing if transactions are driven by inside information is often made difficult by the fact that insiders frequently utilise a variety of information that is very much legal. Insiders may trade for a variety of reasons such as to liquefy their assets or to diversify their portfolio. These acts may not directly be linked to the possession of non-public information. Many insiders are likely to use information that is already public, combined with their superior knowledge of its effect to make trading decisions.³⁵

2.2. Players in Insider Trading

The term "insider" refers to an individual or organisation who, through a fiduciary relationship with the issuer of the security, has information or access to non-public material information. An insider is usually a person who enjoys a position of trust in the company and by its shareholders. It could be the manager, a member of the board, the influential shareholder, or an employee of the company.³⁶

The phrase "inside trading" is a vague word, in a sense that it can also refer to transactions by individuals who may not necessarily be insiders of the company. "Outsiders" who don't even operate or provide services to the company temporarily or on a permanent basis could carry out insider trading.³⁷ These outsiders could be staff of regulating offices that receive information due to their power or office.

³⁴ Id, p. 3

³⁵Brandon N. Cline &Valeriya V. Posylnaya, *Illegal insider trading: Commission and SEC detection*, 58 Journal of Corporate Finance 247 (2019). p. 247

³⁶Harry, *supra note 30*, p.3

³⁷Elsayed Eldaydamony, *Insider Trading Framework in United States and Egyptian Stock Markets*, 2019, p. 12

Insider trading is transacting with someone (inside or outside the company) on a certain material and non-public information regarding the company or the security.³⁸ Insider trading is therefore a general concept that refers to anyone, a person, or an organisation, who obtains beneficial non-public information from within the company or from the market about the issuer's securities and transacts based on that knowledge.³⁹

Outsiders that are given non-public material information and continue to transact on its basis, even knowing its non-public status, are referred to as "tippees". They can be held accountable if the tip has been received in violation of the fiduciary responsibility of the insider-tipper and if the tippee has known or should have learned of such violation.⁴⁰

Some individuals and organisations may not be company employees, but who nevertheless can be considered as insiders. They have the obligation to reveal information they have on the market altogether or to refrain from transacting or passing on such information to those who might trade on the basis of such information. Therefore, including individuals such as auditors, external accountants, stockbrokers, investment bankers, outside counsel, each owe an obligation to use the information endowed to them by their client exclusively for the benefit of the company. These persons are sometimes known to as "temporary insiders" and, at the same time, are barred from dealing in the shares of their clients while they know of the material nonpublic information of the client.⁴¹

Government employees as well must adhere to insider trading laws same as any other person. They owe a duty of trust to their employer, the Government, and the state, to refrain from transacting based on sensitive non-public knowledge gained in the course of their jobs. In certain jurisdictions, government employees may be held responsible for insider trading and even be charged as "tippers" if they reveal confidential information to someone who then transacts on shares on the basis of that information.⁴²

³⁸William Kai-Sheng Wang and Marcel Steinberg, *Insider Trading* (3rd edn, Oxford University Press 2010) Available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1690822, p. 1

³⁹ Id, p. 13

⁴⁰Harry, *supra note 30*, p. 4

⁴¹ Id, p. 5

⁴² Id, p. 6

2.3. Arguments for and Against Prohibition

There is a lengthy scholastic debate on need for the regulation of insider trading. Most of the controversy is regarding whether or not insider trading should be regulated. The controversy is mainly the result of two separate events that took place in the US. First was the use of the 'fairness' argument to justify the enforcement by the Securities and Exchange Commission (SEC) and the US Supreme Courts. Second, Henry Manne's book, "*Insider Trading and the Stock Exchange*", was credited with stimulating the debate on moral principles.⁴³ These arguments will be discussed here below.

2.3.1. Arguments against Prohibition

Deregulators of insider trading argue that if insider trading was conducted successfully and appropriately, the shareholders would approve it. If the shareholders so authorise, the company will comply with that decision. Deregulators define two key areas in which the company profits from insider trading.⁴⁴ First, they claim that insider trading causes the market price of the security to shift to the price at which the security would properly be worth if the material information was available to the public. Theoretically, this benefits the company and society at large by enhancing the accuracy of the price. It is believed that everyone benefits significantly from the right pricing of securities. The "right" price of the security is the price that would have been determined by the market if all details relating to the security had been released publicly. This precise pricing will help society by optimising the distribution of capital investment to the market and reducing the uncertainty of security rates. When a company is allowed to hide material information, the values of its securities are no longer precisely determined by the market. If the non-public information is especially important, the error in the pricing of the security can be significant. The proponents of deregulation therefore claim that, because insider trading advances the goal of market efficiency, the deregulation of insider trading is reasonable.⁴⁵

Second, they argue that insider trading is an effective method to compensate managers for producing information. This potentially benefits the company by giving managers a strong

⁴³ Abdulsalam Albelooshi, *The Regulation of Insider Dealing: An Applied and Comparative Legal Study Towards Reform in the UAE*, 2008 (PhD), p. 21

⁴⁴ Stephen Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38U. Fla. L. Rev. 35 (1986), p. 43

⁴⁵ *Id.*, pp. 42-43

incentive to produce and develop additional information that is of value to the company. Permitting insider trading profits would therefore be the most viable way to compensate managers in large companies.⁴⁶ Manne⁴⁷ argues that the debate against insider trading is, in essence, “an attack on free markets”. He collates the right of insiders to exchange their concepts and innovations with intellectual property, giving the inventor an exclusive right and argues insider trading promotes innovation.⁴⁸ Manne also claims that insider trading encourages any person working for a share company to essentially be an entrepreneur, which is considered a significant advantage to the economy. Individuals, in essence, may sell their ideas to fulfil the need to have huge amounts of funds accessible. It also functions as an economic mechanism that favours the corporation; it will encourage creative workers to take action and to be less orthodox. He often claims that insider dealing enhances business performance because it will show others of the transactions and profits made by insiders and they will also take them as signals to transact their securities. This moves the market price nearer to its 'precise' value.

But this argument has drawn various criticisms.⁴⁹ First, even if insider trading was unchecked and unregulated in such a way that insiders need not conceal their identities from law enforcement, they will continue to conceal their identities from the market and from shareholder to take more of the gains for themselves. The signalling effect is therefore a weak argument. For most other situations mentioned by Manne, the information will still be revealed shortly, so the argument of improvement of market efficiency through insider trading is fairly limited.

There is also the argument that the added performance of the stock market is another justification to promote insider trading stating insider trading and disclosed information play the same exact role in informing shareholders and, as a result, in affecting stock prices. They argue that when an insider transacts, the stock price would represent this adjustment as if the information had been revealed.⁵⁰

⁴⁶ Id, p. 46

⁴⁷ Henry Manne had published many books on law, economics, free market, and securities regulation. His book *Insider Trading and the Stock Market* was a book that influenced the arguments for and against the regulation of insider trading

⁴⁸ Edaydemony, *supra note 37*, p. 15

⁴⁹ Id, p. 16

⁵⁰ Arthur *supra note 28*, p. 8

Another argument advanced by Manne is that insider trading is an effective method to reward company managers. Yet as the market is fundamentally uncertain, managers will not be able to determine what their reward would be. Furthermore, the issue of cadgers and those who would mooch of the persons who generated the person is difficult to address, as the employee who found out the information in passing can be as well-positioned as the managers or analyst who worked hard to come to that information to benefit from insider trading. Additionally, this also creates unhealthy opportunities for corporate executives to exploit corporate revenues for their own personal gains.⁵¹ Permitting insider trading would provide insiders with an opportunity for creativity in creating new goods or plans to improve efficiency. They claim that in allowing insider trading, the needs of insiders would be aligned with those of the interests of the client. Insiders may find it advantageous to improve corporate risk-taking by creating opportunities for growth, that will enhance the value of the company's shares and, in effect, benefiting the shareholders.⁵²

2.3.2. Arguments for Prohibition

The primary argument for prohibiting insider trading is that it is not fair as it hurts investors, issuers, and other market participants, such as stockbrokers. The fairness approach is based on the parity of knowledge which should occur between both parties of the transaction.⁵³ Nevertheless, information parity doesn't quite mean that the parties involved in the transaction will be on a level playing field. Fairness, however, implies that in reality there should be no asymmetry of information on, especially, the securities and firm-specific information, between insiders and the general public. The differences between those who gain more from the market should be based on the utilisation of advanced education, knowledge, or experience in the field to translate that information into rational decisions to buy or sell securities. This suggests that the problem is not information asymmetry by itself but rather how information is obtained. Transacting in good faith attempting to understand market values is permitted and encouraged, however, trading based on what is essentially misappropriated information is what is forbidden.⁵⁴ Besides, when insiders remain quiet about the material information relating to the transaction of the securities of the company, they are lying to the shareholders that have put their faith and confidence in them.

⁵¹ Id

⁵² Kwasi Opoku, What is really wrong with insider trading?, University of Cape Town School of Advanced Legal Studies, p. 17

⁵³ Eldaydemony, *supra note 37*, p. 18

⁵⁴ Id

Ultimately, arguing that insider trading should be deemed a reward for success and creativity for managers would open the door to corruption and impair market efficiency. If a market allows insider trading, the asymmetric informational advantages will help insiders benefit at the expense of other market participants. This not only poses social concerns but also keeps new investors from trusting and entering the market. This reduces liquidity in the market and diminishes the ability to execute its core functions, such as capital allocation and value creation.⁵⁵

The argument that insider trading offers strong motivation for company managers to participate in innovative behaviour has also been challenged as inaccurate, as a person who profits from insider trading is not usually the person credited for creativity. Insider trading doesn't always automatically reward the individual per the significance of the innovation. Insider trading enables insiders to benefit from trading in expectation of both business failures and successes. However, the prospect of gaining insider trading profits can induce corporate insiders to conceal information about the market to advance the insider's interests. As a consequence, the general public will be misinformed and, to the degree of the misinformation, the market will be rendered inefficient. If insider trading is permitted, it will be an incentive for those responsible for ensuring the timely disclosure of such material information to prolong and exploit it to their benefit before it is disclosed.

The regulation of insider trading is primarily based on the premise that insider trading is unfair.⁵⁶ To ensure fair trade, market participants should have equitable access to information. Because insider trading is inherently contrary to equitable access to information, it is thus considered contradictory to fairness.⁵⁷

In the case of the *US v. O'Hagan*⁵⁸, the Supreme Court held that, while information inequality is unavoidable in the financial markets, investors are likely to refrain from investing in a market where transacting based on material nonpublic information is unregulated. Others would need to

⁵⁵Arthur, *supra* note 28, p. 7

⁵⁶Id

⁵⁷Abdulsalam *supra* note 43, p. 23

⁵⁸ *United States v. O'Hagan*: 521 US 642 (1997), was a case in which the Supreme Court made a landmark decision on an insider trading charge. This decision defined the scope of insider trading prohibitions stated under SEC Rule 10b-5 which implements Section 10(b) of the Securities Exchange Act

add expenses to stop transacting with these insider traders or will behave fraudulently to circumvent information disparity.⁵⁹

Moreover, from an economic perspective, if insiders are permitted to trade based on inside information, it would discourage a securities transaction that would not be carried out without insider trading. Ultimately, these illegal transactions would lead the operation of the stock market and change its normal structure, thereby increasing the gap between the reality of the security and its trading prices. This fictional change will result in the stock prices being either undervalued or overvalued, which will weaken the confidence in the market.⁶⁰

Regulating insider trading also encourages timely declaration of information. It will bring about market effectiveness since securities information, be it public or non-public, is completely expressed in its prices. It will also lead to more competitive economies as the value of the securities is effectively expressed in its values. The argument is that if insiders with non-public material information cannot transact with this information, they will be compelled to reveal details promptly and publicly.⁶¹

Restricting insider trading also strengthens the security of the private property. Material non-public knowledge of a company is an intangible asset held by the company and its shareholders. The justification for securing proprietary rights to information useful for the owner of the company is similar to the reason for preventing the violation of the intellectual property. Corporations will only be motivated to innovate and develop strategies if they can reap the benefit of these investments without fearing their infringement. In some jurisdictions, courts permit civil suits by shareholders for insider trading to preserve the shareholders' interest in non-public information of a company.⁶²

Some argue that insider trading is also not a victimless crime. The deregulators argue that the "victims" of insider trading, who are the people that transacted at that price, would nevertheless have traded at that price. However, in reality if that victim had access to the details, they would

⁵⁹U.S. Securities and Exchange Commission, Speech by SEC Staff: Insider Trading – A U.S. Perspective (1998), <https://www.sec.gov/news/speech/speecharchive/1998/spch221.htm> (last visited Jun 13, 2020).

⁶⁰Abdulsalam supra note. 43, p. 20

⁶¹Id p. 21

⁶²Id p. 22

not have traded at that price considering they would have the real information. The flaw with this argument of deregulators is that it extends as well to all those who traded on those shares at the same time that the insider trading took place, rendering the possible number of 'victims' indeterminable and the probable liability of insiders would be high. As the victims in the stock market will typically not know that their rights and interests have been violated, they are not in a place to bring suits to defend their rights unless the regulator recognizes the perpetrator and the act. The issuer of securities is a victim as well. Trustees who have been given access to the sensitive non-public information, have misappropriated that trust through insider trading. The lack of any reliable mechanism for companies to track and deter these fiduciaries from transacting with insider information adds to the importance of government oversight.⁶³

Insider trading has the power to expose the securities issuer to financial hardship and fraud as well. It also has an impact on corporate governance. Effective corporate governance plays a critical role in reinforcing the integrity and effectiveness of capital markets. Corporations that are known for their strong corporate governance as well as efficiency are capable of raising funds through equity financing. Jurisdictions with strong corporate governance policies are also in a position to draw foreign direct investment. Thus, permitting insider trading to reward insiders would cause deficiencies in investment in companies and the economic environment of the country at large.⁶⁴

The argument against insider trading is far greater than the argument for it. If insiders must reveal or refrain from transacting based on inside information, any insider acting in violation of that law would be committing fraud. Insider trading creates real but indistinct, victims of the transaction and damages the reputation of the issuer of the securities. The stock market as a whole often suffers because investors avoid these unfair markets.⁶⁵ Pushes for further oversight of insider trading have been prevalent at the national level in several countries. Countries that have not taken adequate stride to regulate insider trading may put the trust in their financial markets in jeopardy.⁶⁶

⁶³Arthur *supra* note 28, p. 7

⁶⁴Kwasi *supra* note 52, p. 20

⁶⁵Id, 8

⁶⁶Abdulsalam *supra* note 43, pp.45-46

2.4. Deterrence Effects of Insider Trading Laws

The justification for enforcing insider trading regulations is that insider trading undermines public trust in financial markets, increases the cost of capital to companies, and renders it burdensome to fund worthwhile ventures. Regulations are also intended to avoid insiders from exploiting material, non-public information.⁶⁷

Insider trading regulations have been implemented in many jurisdictions during the last few decades. Some countries have prosecuted those that broke the laws. To ensure insider trading laws are successful, they should be implementable. If the laws are not enforceable, the country will potentially be better off without insider trading laws.⁶⁸

There are many reasons why insider trading laws will be less efficient in restricting insiders from transacting in insider information. First, when the stakes are high, influential investors are far more inclined to engage in insider trading to compensate for their limited liquidity. The absence of strong governance allows them more incentives to hide insider transactions through offshore accounts. Second, insider trading is among the ways to expropriate gains from outside investors. Prohibiting insider trading before restricting alternative expropriation mechanisms may allow influential shareholders and the management of poorly governed companies to pursue other means of redirecting assets away from minority shareholders. Influential shareholders or management can use transfer pricing schemes and other methods to redirect assets. When influential owners are involved in redirecting assets, they attribute the resulting poor performance of the company to bad corporate governance.⁶⁹ Any insider trading legislation should therefore be drafted to be enforceable and effectively discourage insider trading.

⁶⁷ H. Nejat Seyhun, The effectiveness of the Insider-Trading Sanctions, *The Journal of Law & Economics*, Vol. 35, No. 1 (Apr. 1992), p. 149

⁶⁸ Bart Frijns, Aaron Gilbert, Alireza Tourani-Rad, Do Criminal Sanctions Deter Insider Trading, Department of Finance, School of Business and Law, Auckland University of Technology, Auckland, New Zealand, (2008), p.1

⁶⁹ Art A. Durnev and Amrita S. Nain, The Effectiveness of Insider Trading Regulation: International Evidence, DICE Report 1/2007, p. 12

Chapter 3 - International Experience

This chapter gives an overview of the insider trading rules in various parts of the world.

3.1. North America

3.1.1. United States

The US was the first country to prohibit insider trading in 1934.⁷⁰ This prohibition was conducted through legislation and common law interpretation. The most important provisions prohibiting insider trading are sections 10(b) and 14(e) of the Securities Exchange Act of 1934. Nevertheless, although these provisions have been used by courts and the Securities and Exchange Commission (SEC) for insider trading cases, they do not mention or define the term insider trading.⁷¹

In the US, the reasons for the prohibition of insider trading stem from fiduciary duties such as a "duty of trust" or "confidence" that are owed by certain individuals related to the company to its shareholders. The determination of who these individuals that have these fiduciary duties is done through the assessment of the position of such persons in relation to the company that would enable them to have either direct or indirect access to non-public material information. If a person is thus in such a position as to gain inside information, they will be referred to as an insider.

In the beginning, the only duty placed on such insiders through the judicial interpretation was a duty to either disclose the non-public information they have come across or to abstain from trading based on such information.⁷² As discussed in Chapter two above, this particular obligation was followed with criticisms as it is claimed that it will have a chilling effect on trading because it deters traders from seeking out information that would help them maximise profits.⁷³

Unlike other jurisdictions, to be discussed below where the prohibition of insider trading in itself is the underlying issue, in the US federal securities laws the important issue is the encouraging the

⁷⁰ Kirthana Singh, Insider Trading laws in India in comparison with the laws in US and UK, <http://www.legalservicesindia.com/article/2567/Insider-Trading-laws-in-India-in-comparison-with-the-laws-in-US-and-UK.html>, last accessed on May 9, 2022

⁷¹ Dariusz M. Budzen & Ania M. Frankowska, Prohibitions against Insider Trading in the US and the European Community: Providing Guidance for Legislatures of Eastern Europe, 12 B.U. INT'L L. J. 91 (1994), p. 94

⁷² Id, pp. 97-98

⁷³ Id, p. 100

disclosure of information. This requirement to disclose takes two forms. The first is that a company that is issuing any type of securities must provide investors with a prospectus that contains comprehensive information about the company. However, this duty is a one-time disclosure requirement, designed to protect the investors. This disclosure is required under the Securities Act of 1933. The second requirement is for companies that are listed on a national securities exchange in the US or have more than 500 shareholders and \$1 million in total assets to issue periodic public reports about themselves. This disclosure requirement is meant to aid not just the potential investors but also the entire investment community. In addition to these, the companies also have the obligation to provide specific information to their shareholders annually or during shareholder meetings, as required by the Securities Exchange Act of 1934. In either of the aforementioned required disclosures, the standard of the disclosure is that of materiality, which refers to the requirement of the disclosure of all the information that is considered to be relevant in enabling investors make an informed decision in deciding to trade in securities.⁷⁴

In addition to the requirement of disclosure, it is also an offence "to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, not misleading." Nevertheless, there has been no specific definition of what can be considered as material, and therefore it requires a case-by-case analysis of each situation as to whether a fact can be deemed material or not. The jurisprudence also has not specified what could be considered as material information.⁷⁵ Therefore, even in case law, materiality is determined on a case-by-case basis.

The other element necessary in determining whether an information is inside information is its non-public nature. Non-public information has been defined as information that has not been published or disseminated in a way which makes it available to investors interested in trading securities. What is usually considered as effective public dissemination consists of disclosing the relevant information in SEC reports or reports submitted to the stock exchanges and/or submitting the necessary information to be published in press releases.⁷⁶

⁷⁴ Id

⁷⁵ Dariusz M. Budzen & Ania M. Frankowska, Prohibitions against Insider Trading in the US and the European Community: Providing Guidance for Legislatures of Eastern Europe, 12 B.U. INT'L L. J. 91 (1994), p. 103

⁷⁶ Id, p. 105

Insider trading in the US is an offence that entails a rigorous punishment of up to ten years imprisonment."⁷⁷ In this criminal case the SEC is required to show that the defendant had necessary mens rea which is the "intent to deceive, manipulate or defraud", as mere negligence is not sufficient to establish criminal liability in the event of insider trading.⁷⁸

In the US, the Securities Exchange Act of 1934 established the Securities and Exchange Commission (SEC) as an independent regulatory authority with the role of regulating activities falling within the federal securities laws of the country.⁷⁹ The SEC has three broad mandates: protecting investors, maintaining a fair, orderly, and efficient market, and facilitating capital formation.⁸⁰ The SEC has Rule 10b.5 which dictates the prohibition of insider trading. The SEC uses various ways to track insider trading such as market surveillance; tips and complaints; information from SROs, the media, and other stakeholders.⁸¹

In addition to the SEC, the Financial Industry Regulatory Authority (FINRA) serves as a self-regulatory organisation (SRO). The FINRA provides surveillance of potential market manipulations of other financial crimes such as insider trading, to ensure the protection of the market⁸². After a thorough investigation of potential market abuses committed, if it finds that there is indeed a market manipulation, such as insider trading, or other such crimes, it is empowered to take enforcement actions. The enforcement actions could include disciplinary cases that could lead to punishments such as fines, suspension or, as the authority empowered to licence and revoke licence of members, revoking the licence of the members found to have violated the laws.⁸³ In

⁷⁷ Ramzi Nasser, The Morality of Insider Trading in the US and Abroad, 52 OKLA. L. REV. 377 (1999), p. 379

⁷⁸ Id, pp 106-107

⁷⁹ Congressional Research Service, Introduction to Financial Services: The Securities and Exchange Commission (SEC), April 15, 2020, p. 1

⁸⁰ ibid

⁸¹ Elvis Picardo, How the SEC tracks insider trading, Investopedia, 22 October 2021

<https://www.investopedia.com/articles/investing/021815/how-sec-tracks-insider-trading.asp>, last accessed on May 9, 2022

⁸² FINRA, Advancing Market Regulation and Transparency, <https://www.finra.org/media-center/advancing-market-regulation-transparency>, last accessed on May 9, 2022

⁸³ FINRA, Enforcement, <https://www.finra.org/rules-guidance/enforcement>, last accessed on May 9, 2022

April 2021, FINRA investigated and barred a staff of Goldman Sachs Group, Inc, one of the largest global financial institutions, for insider trading.⁸⁴

For a better protection of investors and the market at large through corporate governance, the U.S has a legislative act, the 2002 Sarbanes-Oxley Act.

The insider trading cases of Albert H. Wiggin⁸⁵, Ivan Boesky⁸⁶, R. Foster Winans⁸⁷, and Martha Stewart⁸⁸ in the US had captured the attention of the US market and media.

⁸⁴ Michelle Ong, FINRA Bars Research Analyst for Insider Trading, New Release, <https://www.finra.org/media-center/newsreleases/2021/finra-bars-research-analyst-insider-trading>, Published on April 20, 2021, last accessed on May 9, 2022

⁸⁵ Wiggin was the president of Chase National Bank from 1911 to 1930. In the 1929 Wall Street Crash, Wiggin acquired millions of dollars by shorting 40,000 shares of the Chase Bank, by betting against his own company to succeed. But he bought back these shares through other family-owned corporations. He earned more than 4 million dollars on this trade. He was made to testify before the Senate Banking and Currency Committee in 1933 where he admitted that he shorted the shares of Chase National Bank before the Stock Market Crash. During the time, there was no law against shorting shares of one's own company. see The New York Times, November 1, 1933, <https://timesmachine.nytimes.com/timesmachine/1933/11/01/issue.html>, last accessed on May 9, 2022

⁸⁶ Ivan Boesky was an investment banker. He was a "take over arbitrageur" – as his work and profits revolve on profiting from the inefficiencies of the market. He bought shares of companies that were about to be taken over by other companies, making millions in the process. In 1985, he published "*Merger Mania: Arbitrage, Wall Street's Best Kept Money-Making Secret*". In 1986, the U.S Securities and Exchange Commission stated that Boesky had made use of confidential inside information on the takeovers before the deals were made public and he used that information to trade shares. He was convicted with Insider Trading where he pleaded guilty and entered into a plea agreement. He was sentenced to three and a half years in prison and a one hundred million dollars fine, the biggest fine on a securities law violation. His charge led to the passing of the Insider trading Act of 1988. See <https://www.investopedia.com/terms/i/ivan-boesky.asp> and <https://www.britannica.com/biography/Ivan-Boesky>, last accessed on May 9, 2022

⁸⁷Winnans was a columnist for the Wall Street Journal in early 1980s, who profiled a stock in every column. His opinion was really strong that the price of the stocks would fluctuate based on his opinion. He then made deals where he leaked his column to certain stockbrokers before they were published. He was convicted of violating securities law. However, his case was tricky since he was not leaking material information but rather opinions. He pleaded not guilty after stating that he didn't act ethically, but nonetheless, his actions were not illegal. He was sentenced to 18 months in prison. see <https://www.wsj.com/articles/SB853712979180883000> and <https://www.chicagotribune.com/news/ct-xpm-1985-01-31-8501060812-story.html>, last accessed on May 9, 2022

⁸⁸ In 2003, TV Show Host Martha Stewart was charged with securities fraud for illegal insider trading. She was alleged to have sold her stocks in ImClone Systems, Inc a biopharmaceutical company after receiving an insider information that the Food and Drug Administration (FDA) was going to reject an application filed by ImClone Inc for a cancer treatment medication "Erbix". She sold all of the 3,928 shares of ImClone she had. She was convicted and sentenced to five months in prison. <https://www.sec.gov/news/press/2003-69.htm> and <https://www.chicagotribune.com/sns-ap-martha-stewart-chronology-story.html>, last accessed on May 9, 2022

3.2. Europe

3.2.1. United Kingdom

During the drafting of the first insider trading laws in the UK, the main issue in question was that of the protection of “corporate information” which related to the information about the finances and functioning of companies. This has changed in recent times as most cases of insider trading are based on inside information relating to corporate reorganisation such as inside information on mergers, acquisitions, and takeovers.⁸⁹

It was in the 1980s that the UK officially proclaimed insider trading as a criminal offence. Before the 1980s, the insider trading restrictions were mainly an issue of self-governance and expected to be handled by the companies. It is only after the enactment of the Companies Act of 1980 that insider trading become illegal. The Companies Act of 1980, similarly to the US Securities Exchange Act of 1934, focuses on the breach of a fiduciary duty by a person that has price sensitive, material information that is yet to be published. These persons, known as “connected persons”, instead of the normally used term of “insiders”, are persons who have a direct relationship with the company issuing the securities during the insider trade, or at any time in the preceding six months, or individuals who receive inside information or tips from “connected individuals”. Under the UK’s insider trading rules, connected persons include a wide range of persons related with the company such as its directors, officers, or senior employees and also the professional advisors of the company. Both a connected person and persons that receive inside information/tips from a connected person are prohibited from dealing in securities and advising others to deal in such securities. They are also prohibited from communicating this price-sensitive information that is unpublished to anyone who can be expected to trade in the securities. Persons that are not directly connected with the company issuing securities but however are related to another company, such as staff of audit firms or consulting firms, putting them in a position where they could get insider information are also prohibited from dealing based on this unpublished price-sensitive information.⁹⁰

⁸⁹ Kern Alexander, UK Insider Dealing and market abuse Law: Strengthening Regulatory law to Combat Market Misconduct (Chapter 21), p. 409

⁹⁰ T. Peter LEE, Law and Practise with Respect to Insider Trading and Trading on Market Information in the United Kingdom, Journal of Comparative Corporate law, and Securities Regulation 4 (1982), North-Holland Publishing Company, p. 389

In the 1990s, the UK promulgated the “Implementation of the 1990 European Community Directive on Insider Dealing” along with the remaining members of the European Community. This directive was followed by the Criminal Justice Act of 1993 which further strengthened the regulation of insider dealing in the UK. The Criminal Justice Act also established the prohibited conduct of insider trading.⁹¹ According to this act, it became illegal to deal in price affected securities⁹² based on inside information. Both the acts of encouraging another to trade price-sensitive securities on the basis of insider information, and knowingly disclosing such an inside information to another person to be used for dealing in securities are also prohibited. The first offence of dealing in price sensitive securities occurs when a connected person has confidential information and uses that information to deal in these securities. The second offence of encouraging others to deal in price sensitive securities occurs where a person encourages another person to trade price sensitive securities on the basis of inside information. It should be noted that this second offence does not actually require the actual act of dealing in the securities. The mere fact that there was an incitement is adequate. The third offence is that of disclosing inside information that has not been made public yet, unless it is done for the proper functioning of the work such as required by government or regulatory bodies.⁹³

An individual found guilty of the crime of insider trading will have to pay a fine (there is no maximum limit to the fine that is to be paid) or face imprisonment ranging from 6 months to 7 years, in some cases the punishment could be a combination of both.⁹⁴

A peculiar element of the insider trading rules of the UK is that the criminal liability insider trading entails is for individuals. Corporations and other entities would not be held liable for the offence of insider trading, nevertheless partnerships were included in the criminal liability.⁹⁵

Similar to the “connected persons” under the Companies Act of 1980, there are two types of insiders under the Criminal Justice Act. The first are primary insiders who are persons that have

⁹¹ Kern, *supra* note 89, p. 411

⁹² It should be noted that the term price affected securities means that the price of the securities would be significantly affected if the information was to be made public.

⁹³ Priyam Raj Kumar, A Critical Analysis of Insider Dealing Under U.K. and U.S. Law, *International Journal of Law Management and Humanities*, Vol. 2, Issue 4, 2019, pp. 16-17

⁹⁴ *Id.*, p. 18

⁹⁵ *Id.*, p. 412

direct access to insider trading which include directors, or employees of a company. The secondary insiders are persons who receive the information from another inside source. These would include persons that have professional relationships with the company issuing the securities such as brokers and analysts.⁹⁶

After taking over from the Financial Services authority (FSA) in 2013, the Financial Conduct Authority (FCA) became the statutory regulatory organ that regulates the financial services industry of the UK, with enhancing market integrity as one of its core roles. The FCA is empowered to licence or register members of the financial services industry in the UK.⁹⁷ The FCA is also mandated to investigate and avert market abuse, including insider trading. Through the assessment of transactions and data reported by members or through other medium, the FCA monitors the activities of its members in the UK, if the FCA finds evidence of market abuse and insider trading, it has the power to take enforcement measures that range from disciplinary actions such as fines, injunctions, and barring of members, to criminal sanctions that could amount to 10 years of imprisonment.⁹⁸

Before 2001, the UK had nine different self-regulators in the financial sector. However, through the Financial Services and Markets Act 2000, these regulators were brought together and merged into one: The Financial Services Authority. In 2013, the Financial Services Authority split into the Financial Conduct Authority and the Prudential Regulation Authority, with the latter responsible for the regulation of banks.⁹⁹

As an added measure to ensure the interests of shareholders and the market are protected, the UK has the Corporate Governance Code (formerly known as the Combined Code) published by the Financial Reporting Council in 2018.

⁹⁶ Id

⁹⁷ Financial Conduct Authority (FCA), About the FCA, <https://www.fca.org.uk/about/the-fca>, last accessed on May 9, 2022

⁹⁸ Financial Conduct Authority (FCA), Market Abuse, <https://www.fca.org.uk/markets/market-abuse>, last accessed on May 9, 2022

⁹⁹ DAC Beachcroft, 20 Years On: Is Financial Services Regulation in the UK still fit for purpose, Published 1 December 2021, <https://www.dacbeachcroft.com/en/gb/articles/2021/december/20-years-on-is-financial-services-regulation-in-the-uk-still-fit-for-purpose/>, last accessed June 25, 2022

In 2016, a court in London ruled in favour of the FCA on an insider trading case nicknamed “Operation Tabernula”. The FCA, teamed up with the National Crime Agency for eight years to uncover one of the largest cases of insider trading in the UK.¹⁰⁰ The court found two of the defendants guilty of conspiring to insider deal on securities of five companies from November 2006 to March 2010. The persons who were found guilty, Martyn Dodgson and Andrew Hind, were found to have agreed to deal secretly on the basis of inside information. Dodgson received inside information from the investment banks he works in, he passed such information to Hind, who used the information to deal in securities for the benefit of the both of them. In order to cover their tracks, the perpetrators used unregistered mobile phones (burner phones), encoded and encrypted their data and used cash and payments in kind as well as Panamanian Bank accounts not to leave a financial trail.¹⁰¹ The companies that have been victims of insider dealing were, Scottish & Newcastle plc in October 2007, Paragon Group of Companies plc in July 2008, Just Retirement plc in October 2008, Legal & General plc in February 2009, and BSkyB plc in March 2010. Martyn Dodgson was sentenced to four and a half years in prison while Andrew Hind was sentenced to three and a half years.

3.3. Asia

3.3.1. India

In 1992, India promulgated the Securities and Exchange Board of India (SEBI) Act to govern the securities market also regulating insider trading in the Indian stock market. Based on this act, insider trading requires the existence of an “insider”, namely a person that has relations with the company either through employment or having inside information that is non-public through direct relations with the company. The types of information considered as inside information were mainly financial reports, the decision taken on the payment or otherwise of dividends, or changes

¹⁰⁰Independent Digital News and Media. (2018, January 19). City watchdog secures just 12 insider trading convictions in five years. The Independent <https://www.independent.co.uk/news/business/news/fca-city-london-insider-trading-convictions-five-years-financial-conduct-authority-a8167486.html>, last accessed on June 25, 2022

¹⁰¹Insider dealers sentenced in Operation Tabernula trial. FCA. (2021, November 23). Retrieved September 23, 2022, <https://www.fca.org.uk/news/press-releases/insider-dealers-sentenced-operation-tabernula-trial>, June 25, 2022

in company policy or plans. Insider trading occurs when the dealing of shares is made based on that information before it was made public.¹⁰²

It took another 17 years for India to include persons that are not normally considered insiders within the company but can in any case be engaged in insider trading. Currently, in the Indian system, the term insider has been given a wider definition and includes “any person including corporate officers, directors, employees, friends, business associates, family members, persons and other tippers with inside information that can influence stock prices”¹⁰³. The act of inciting or encouraging another to deal or to communicate and counsel another person to directly or indirectly deal in price-sensitive securities based on unpublished information is also considered as the crime of insider trading. Persons guilty of the crime of insider trading in India might incur a fine of three times the profit they made and receive a prison sentence of a maximum of 10 years. Under the SEBI Act, the expansion of the meaning of the term insider has a strict impact as family members of a director or officer who own securities in the same company their family member works in have the duty of disclosure when they want to deal in securities.¹⁰⁴

Through the SEBI Act of 1992, the Securities and Exchange Board (SEBI) has been granted the power to regulate the capital market and protect investors.¹⁰⁵ SEBI was set up to protect investors from unfair trading practices. As such, it has the power to monitor the activities of the capital market. In general, the SEBI has three main functions: protective, regulatory, and developmental. It is through its protective function that the SEBI prohibits insider trading and other unfair trading practices. To achieve this protective role, SEBI exercises its regulatory function of legislating rules and regulations aimed at governing the participants of the market.¹⁰⁶ SEBI also has the power to inspect the books, register or documents of the market participants.¹⁰⁷ The act has given the SEBI the same power as a civil court by giving it the powers to order the discovery and production of

¹⁰² Legal Services India, Insider Trading Laws in India, <https://www.legalserviceindia.com/article/1421/insider-trading-laws-in-india.html>, last accessed on April 19, 2020

¹⁰³SEBI Act No. 15, 1992

¹⁰⁴ James H. Thompson, A global comparison of Insider Trading Regulations, International Journal of Accounting and financial Reporting, Vol. 3 No. 1, 2013, p. 8

¹⁰⁵Ifraan Nawaz Khan and M. Kannappan, A Study on the role of SEBI in the Indian Capital Market, International Journal of Pure and Applied Mathematics, Vol. 119, No. 17, 2018, p. 764

¹⁰⁶Tavaga, SEBI, <https://tavaga.com/tavagapedia/sebi/>, last accessed 25 June 2022

¹⁰⁷ Section 11(2)(a) of The Securities and Exchange Board of India Act, 1992 No.15 of 1992, [4th April ,1992.]

books and other documents to be presented, summoning and enforcing the attendance of persons, inspection of books and records of persons and companies as well as issuing persons that will examine witnesses or documents produced.¹⁰⁸ If such investigations find that an offence has been committed, the SEBI can suspend the trading of that security¹⁰⁹, prevent the person who undertook the fraudulent trading practice from undertaking share dealings¹¹⁰, suspend senior personnel from their positions¹¹¹, retain the profits of the securities traded on fraudulent basis¹¹², attach a restriction on the bank accounts of such persons¹¹³, or take other measures considered necessary for the protection of the market.

With regards to self-regulation, what makes the Indian experience different from its global counterparts is that stock exchanges in India had regulated themselves long before the establishment of the SEBI, although their success could be questioned. In 1992, the Securities and Exchange Board of India Act prescribed for the promotion and regulation of SROs.¹¹⁴ In 2013, the first official SROs of the financial industry of India was established¹¹⁵ was established on the basis of the SRO regulation of 2004. In order to be recognized as an SRO, the entity needs to have “discharging the functions of an SRO as one of its main objectives”¹¹⁶. Other requirements are that the entity needs to have adequate infrastructure¹¹⁷, and the professional competence, financial soundness and general reputation of fairness and integrity of board¹¹⁸. After its formation, the SRO will have the obligation to stipulate and enforce a standard for its members¹¹⁹. To ensure the

¹⁰⁸ Id, Section 11(3)

¹⁰⁹ Id, Section 11(4(a))

¹¹⁰ Id, Section 11(4(b))

¹¹¹ Id, Section 11(4(c))

¹¹² Id, Section 11(4(d))

¹¹³ Id, Section 11(4(e))

¹¹⁴ The World Bank, India: the Role of Self-Regulatory organisations in Securities Market Regulation, June 2007, <https://openknowledge.worldbank.org/bitstream/handle/10986/12720/703570PNTOP10200SROOPolicy0Note2007.pdf?sequence=1&isAllowed=y> p. 16

¹¹⁵ CFA Institute, Self-Regulation in the Securities Markets: Transitions and New Possibilities, 2013, <https://www.cfainstitute.org/-/media/documents/article/position-paper/self-regulation-in-securities-markets-transitions-new-possibilities.ashx>, p. 25

¹¹⁶ Art. 4(b), Self-Regulatory Organizations Regulation, 2004, The Gazette Of India Extraordinary, Part – III – Section 4, Published By Authority Securities And Exchange Board Of India Notification, Mumbai, the 19th day of February 2004

¹¹⁷ Id, Art. 4(d)

¹¹⁸ Id, Art. 4(e)

¹¹⁹ Id, Art. 14(3)

enforcement, the SRO has been given the power to investigate and inspect its members¹²⁰, all the while treating them with fairness and transparency¹²¹. In case a member is found to have violated the rules stipulated in the norms, the punishment could include the forfeiture of shares, suspension, or expulsion of members¹²².

In terms of corporate governance, India has Clause 49 of the SEBI guidelines on corporate governance which came into effect in 2005.

3.4. Africa

3.4.1. Nigeria

In Nigeria, it was in 1990 that insider trading was strictly regarded as an offence after a written recommendation to that effect was presented by the Nigerian Law Reform Commission (NLRC)¹²³

The Investment and Securities Act (ISA) of 2007 forbids an insider from dealing in the securities of a company if he has information which he knows are unpublished and price sensitive in relation to those securities. The Act prohibits any individual from receiving and using such unpublished price sensitive information from an insider, if that insider has been connected with the company at any time within the six months preceding the reception of the information by the outsider. This act also forbids the individual who obtains such information from using it to deal in the securities of another company as long as the information relates to any transaction between the first company and the latter company. The provision of the Act operates to prohibit public officers including former public officers who by virtue of their positions come into possession of unpublished price sensitive information and deal in or encourage any other person to deal in that security or communicate this information to any person that can reasonably be expected to utilise such information for trading in that company's securities. The Act permits an individual to use such information for non-profit purposes or the avoidance of loss if the person is a receiver, liquidator, or trustee in bankruptcy.¹²⁴

¹²⁰ Id, Art. 14(4)

¹²¹ Id, Art. 14(b)

¹²² Id, Art 15(3)

¹²³Veronica Ekundayo, Amurawaiye Adeoye, Olalekan Moyosore Lalude, Insider Trading under the Nigerian legal Framework, International Company and Commercial Law Review, Issue 6, 2020, p. 374

¹²⁴ A.A. Oluwabiyi, A Comparative legal Appraisal of the problem of insider trading in Mergers and Acquisitions, Frontiers of Legal research, Vol. 2, No. 1, 2014, p. 11. <https://core.ac.uk/download/pdf/236306822.pdf>

“Inside information” in Nigeria has been defined to mean information related to an issuer of a security or the issuer’s securities, either directly or indirectly, which has not been published and whose disclosure may have a significant effect on the price of securities and stocks so listed and traded or derivative instruments which are linked to those securities.¹²⁵

The 1979 Securities and Exchange Commission Act established Nigeria’s Securities and Exchange Commission. This act was later amended in 1988 with the same name but bestowing broadened powers to the Securities and Exchange Commission. There have been subsequent amendments in 1999, and then in 2007.¹²⁶ One of the powers of the Securities and Exchange Commission is to “protect the integrity of the securities market against all forms of abuses including insider trading”.¹²⁷ In addition, this commission can “in furtherance of its role of protecting the integrity of the securities market, seek judicial order to freeze the assets (including bank account) of any person whose assets were derived from the violation of this act, or any securities law...”.¹²⁸ For this purpose, the Securities and Exchange Commission promulgated the Securities and Exchange Commission Rules and Regulations as well as the Securities and Exchange Commission Code of Corporate Governance for Public Companies 2011. The SEC rules and regulations under rule 110(3) prohibits insider trading while under Rule 17 of the SEC code of corporate governance the concept of related parties was broadened to include the insider’s immediate family members.¹²⁹ If the Securities and Exchange Commission finds that there has been a breach of these rules, it has to first notify the persons or companies of such breach and can issue guidelines and circulars to ensure compliance.¹³⁰ Failing to secure the desired compliance in this case, in particular for insider trading cases, the Securities and Exchange commission has the power to determine the amount of compensation due as a civil case matter.¹³¹ The Securities and Exchange Commission may also

¹²⁵ Veronica et al, supra note 123, p. 374

¹²⁶ Okunor Cecil Nwachuwu, The Role of Securities and Exchange Commission (S.E.C) in Public Issue of Securities and the Structure of the Nigerian Capital Market, pp. 93-95

¹²⁷ Investment and Securities Act of 2007, Section 13 (n)

¹²⁸ Id, Section 13(x)

¹²⁹ Iheanacho Nelson, Closing the door on the Insider traders: An appraisal of the concept of insider trading in various jurisdictions on the journey to Nigeria, UNILAG Law Review, Jan 23, 2019 <https://unilaglawreview.org/2019/01/23/closing-the-door-on-the-inside-traders-an-appraisal-of-the-concept-of-insider-trading-in-various-jurisdictions-on-the-journey-to-nigeria/>, last accessed on June 25, 2022

¹³⁰ Joseph Onele, Insider Dealing under Nigerian Law: Any new lessons, The Gravitas Review of Business and Property Law, June 2016, Vol. 7 No. 2, p. 8

¹³¹ Id, p. 10

bring up criminal charges for more than 500,000 Nigerian Naira for a physical person and more than 1,000,000 Nigerian Naira for corporations.¹³²

In 1961, the Lagos Stock Exchange officially began its operations sixteen years later in 1977, it was officially replaced by the Nigerian Stock Exchange.¹³³ The Investments and Securities Act of 2007 gives self-regulatory entities such as the Nigerian Stock Exchange the power to expel, suspend or discipline their members that fail to respect the rules of the Act, the rules of the securities exchange itself or “just and equitable” trading principles.¹³⁴ Insider trading is one of the practices prohibited by the Act.¹³⁵

Nigeria has three major legislations on corporate governance. These are the Companies and Allied Matters Act (CAMA), the Investment Securities Act 2007 (ISA) and the Banks and Other Financial Act (BOFIA).

3.4.2. Kenya

In Kenya, insider trading is dealt with section 32B and following the Capital Markets Act Chapter 485A. Insider trading is defined as: “the dealing in listed securities or derivatives that are price affected relying on information which has not been made public... and if such information were to be made public, it could have material effect on the price of securities or derivatives.”¹³⁶

The Capital Market Act states that when a person that is in possession of inside information encourages another to deal in securities based on that information or discloses that information, it will be considered as the act of insider trading.¹³⁷

An important element in the prohibition of insider trading in Kenya is the concept of “information”. As defined above, insider trading is only committed when a person that has inside information uses it or encourages another to deal in securities. However, this Act does not give a definition of

¹³² Id, p. 11

¹³³Nwanne Titus Freeman Ifeanyi, The Nigerian Stock Exchange: A bane for sustainable economic development, *European Journal of Business and Social Sciences*, Vol. 3, No. 12, March 2015, p. 22

¹³⁴ Nigerian Investments and Securities Act, 2007, 29(2)(b)

¹³⁵ Id, 111(1)

¹³⁶ Mr. Shem Oganga Nyang’au , A Peek into Insider Trading In India and Kenya; a Critique of the Legal Regime, *Journal of Research in Business and Management* Volume 7, Issue 5 (2019), pp. 69-73 ISSN(Online):2347-3002, p 2

¹³⁷ Nigerian Investments and Securities Act, 2007, Section 32A and 32B

the term information. The act merely defines what will be considered as information made public.¹³⁸

Based on the Amendment by Act No. 48 of 2013, the term insider was defined to refer to persons who by virtue of either duty, such as directors, managers and other employees, or shareholding in the company have access to sensitive information in regard to the function of the company.

The Capital Markets Act Chapter 485A under Section 32E has criminalised insider trading and proscribes the penalties for it. The penalties proposed are different for first time or second time offenders. For first time offenders, the fine proposed does not exceed Kshs. 2.5 million or 2 years in jail, in addition to the payment of the amounts gained or losses avoided due to insider trading. If it's a corporation, the fine is up to Kshs. 5 million in addition to the payment of the amount gained or losses avoided. For second time offenders, the fine is an amount that does not exceed Kshs. 5 million or an imprisonment of 7 years in addition to a payment of an amount that is double the gains made or losses avoided. In case of a corporation, that fine is increased to a fine not exceeding Kshs. 10 million. The individual could also be barred from dealing with those securities or causing another person to deal in those securities for 6 months according to Section 33 of Capital Markets Act.¹³⁹

Set up by an Act of the Parliament in 1989, the Capital Markets Authority of Kenya is the independent government financial regulatory agency governing the capital market and its intermediaries.¹⁴⁰ The Capital Markets Authority of Kenya is primarily mandated to enforce the Capital Markets Act and other related regulations.¹⁴¹ The authority has been endowed with the power to register and licence intermediaries such as stockbrokers, fund managers, advisors as well

¹³⁸ Anne Kotonya, Combating Insider Trading in Kenya's Capital markets: Challenges and Opportunities for Reform, Faculty of Law, Master's Thesis, University of Nairobi, November 2012, <https://su-plus.strathmore.edu/bitstream/handle/11071/3790/Combating%20insider%20trading%20in%20Kenya's%20capita%20markets.pdf?sequence=1&isAllowed=y>, p. 44 -45

¹³⁹ The Accountant, Insider Trading Conundrum Explained, <https://accountantjournal.com/insider-trading-conundrum-explained/>, June 25, 2022

¹⁴⁰ Capital Markets Authority, Our History, published 24, May 2019, <https://www.cma.or.ke/index.php/about-us/our-history>, last accessed June 25, 2022

¹⁴¹ Dr. Jacob K. Gakeri, Regulating Kenya's Securities Markets: An Assessment of the Capital Market Authority's enforcement jurisprudence, International Journal of Humanities and Social Science, Vol. 2, No. 20 [special issue, October 2012], p. 274

as depositaries.¹⁴² It is also entrusted with the task of monitoring the market and gathering the necessary information to ensure the smooth functioning of the market. This power enables the Capital Markets Authority of Kenya to demand and collect the necessary information as well as conduct both on and off-site investigation.¹⁴³ In cases of violations of the various legislations aimed at regulating the capital market, the Capital Markets Authority of Kenya has the power to remove or replace the board members or other senior personnel with a competent “statutory manager” that can exercise the powers necessary to manage, control and conduct the affairs of an intermediary.¹⁴⁴ In more severe cases, the Capital Markets Authority of Kenya has the power to levy financial penalties and even to “recover amounts equal to double the benefit accruing to the person from the breach”.¹⁴⁵ It also has the power to order restitution.¹⁴⁶

In Kenya, the best-known self-regulation entity in the stock markets industry is the Nairobi Stock Exchange (NSE). The NSE was established in 1954 as a voluntary association with the mandate of, among others, regulating the share trading activities in the country.¹⁴⁷ The NSE, which was designed as a self-regulatory entity, was entrusted in developing the Kenyan stock market by “ensuring smooth trading activities”¹⁴⁸. As a securities exchange, the NSE, has the power to reprimand, fine, suspend, expel, or take other disciplinary measures against members or listed companies that violate either its rules or the rules set under the Companies Act of Kenya and the Capital Markets Act of Kenya.¹⁴⁹ In doing so, the securities exchange will have to inform the Capital Markets Authority in writing.

The Kenyan Capital Markets Authority Published the Code for Corporate Governance in 2016. This corporate governance regulates directors, officers, influential shareholders to disclose or report their holding, transactions on shares or other events that have the power to impact the value of the shares, as well as to ensure the proper governance of companies and fairness to shareholders.

¹⁴² Id, p. 275

¹⁴³ Id, p. 276

¹⁴⁴ Id, p. 279-280

¹⁴⁵ Id, p. 281

¹⁴⁶ Id, p. 282

¹⁴⁷ Rose W. Ngugi, Development of the Nairobi Stock Exchange: A Historical Perspective, KIPPRA Discussion Paper No. 27, p. 11

¹⁴⁸ Id, p. 12

¹⁴⁹ Laws of Kenya, The Capital Markets Act, Chapter 485A, 22.1

Chapter 4 - Insider Trading in the framework of the Ethiopian Securities Exchange (ESX)

4.1. Introduction to the Ethiopian Securities Exchange (ESX)

Since 1956, with the first ever public subscription offer issued by Ethiopian Abattoirs¹⁵⁰, Ethiopian companies have recognized the value of selling shares of their company for capital formation or increase.

The increase in the number of share companies that floated their shares and the interest of the public to acquire them necessitated the establishment of an institution that is mandated to deal with activities related to the sale and purchase of shares¹⁵¹. At the time it was the State Bank of Ethiopia that took the initiative and created a unit within the bank that handled matters relating to share dealings¹⁵². The Bank, after witnessing the success of this unit, was motivated to establish the Share Exchange Department within it in 1960. The Share Exchange Department was mandated to participate in trading shares, increasing public confidence, and creating stability in the market¹⁵³. When this department began, there were only five companies that were listed and whose shares were publicly traded. But from its establishment in 1960 to 1963, six more companies were included to take that number to eleven listed companies¹⁵⁴. This expansion as well as the increase in the amount of the share purchases and total sales pushed the National Bank of Ethiopia (which succeeded the central banking functions of the State Bank of Ethiopia) to establish a better institution that deals with share trading. The bank felt the need to establish an institution that is well organised and includes other financial institutions and even private share dealers that will directly participate in the sale and purchase of shares.

¹⁵⁰Araya Debesay and Tadevos Haregework, 1994, "Towards the Development of Capital Market in Ethiopia," in Getachew Yoseph and Abdulhamid Bedrikello, (eds.), *The Ethiopian Economy: Problems and Prospects of Private Sector Development (Proceedings of the Third Annual Conference on the Ethiopian Economy)* (Addis Ababa University Press, Addis Ababa, 1994), p. 231

¹⁵¹ Id

¹⁵² Id

¹⁵³ Id

¹⁵⁴ J. D Von Pischke, *Shares and Share Trading in Addis Ababa* (1968).

This idea gave birth to the Share Dealing Group that was established in 1965. The Share Dealing Group had, as members; the National Bank of Ethiopia, Commercial Bank of Ethiopia, Addis Ababa Bank, Development Bank of Ethiopia, Investment Bank of Ethiopia, Mr. Alfred Abel, who had years of experience in the banking sector¹⁵⁵, and the Sabean Utility Corporation. The Share Dealing Group had its own rules and regulations. The Rules and Regulations had 12 articles that describe the aim of the group, its strategies, and the methods it uses to trade shares¹⁵⁶.

The Share Dealing Group was very successful in its dealings. It had more than twenty-two companies whose shares were floated in the Group. It also played a vital role in building public confidence towards share dealings¹⁵⁷. But this share dealing group was dismantled in 1974 following the revolution that brought about the military government, Dergue¹⁵⁸. This dismantling was a result of the shift in the economic structure of the country to the command economy system¹⁵⁹.

After the overthrow of the Dergue by the Ethiopian People's Revolutionary Democratic Front (EPRDF), the need for the stock market and privatisation in Ethiopia had been a contentious issue for a long time. The boom in Ethiopia's economy following the economic system reform had led to the increase in share companies, particularly in the financial sector with entities such as banks, insurance companies and microfinance institutions. These entities are, by law, required to be formed as share companies.¹⁶⁰ Other industries such as real estate, agriculture and manufacturing have also been established in the form of share companies.

The dealing of shares however has been difficult and unstructured. The stringent requirements placed by the National Bank of Ethiopia on financial institutions has made them attractive investments through the purchase of shares. Other sectors however have not been so lucky.

¹⁵⁵Peter Symes, Banknotes and Banking in Abyssinia and Ethiopia, Pjsymes.com.au (2013), <http://www.pjsymes.com.au/articles/Abyssinia.htm>, last visited Apr 18, 2020

¹⁵⁶ Id

¹⁵⁷Asamenew supra note 10, p.9

¹⁵⁸ Ruediger Ruenker, *'Market Potential Assessment and Road Map Development for the Establishment of Capital Market in Ethiopia'*, (Produced and distributed by the Addis Ababa Chamber of Commerce and Sectoral Associations), 2011, p. 1

¹⁵⁹ Jetu, supra note 11, p. 440

¹⁶⁰ Banking Business Proclamation No. 592/2008 Art. 2(1) and Art. 4(1(d)), Insurance Business Proclamation No. 746/2012 Art. 4(1(d)) and Micro-financing Business Proclamation No. 626/2009 Art. 5(1(c))

Without adequate regulation and lack of a common marketplace for trading shares, raising capital had been “uncoordinated and largely informal”.¹⁶¹ This has led to an asymmetrical interest in financial company shares as opposed to shares of non-financial companies.¹⁶² Shareholders of financial companies usually sell their shares through the financial department of the share companies themselves or through individual brokers, without auction although most times there is much more demand, and their shares are sold at much higher values. Shareholders of non-financial companies however face more challenges and likewise had to pay higher commission rates to brokers in this unstructured market.¹⁶³

The EPRDF government has considered establishing a stock market for many years, but no such institution had been established during its reign. In 1995¹⁶⁴ and again in 2001¹⁶⁵, draft proclamations were prepared after discussions with various stakeholders. However, neither of these draft proclamations saw publication in the Negarit Gazettea.

After two decades of deliberation and discussions, the government of Ethiopia, enacted Proclamation No 1248/2021 The Capital Markets Proclamation finally breaking ground on the journey to the establishment of a securities exchange in Ethiopia.

4.2. Proclamation No 1248/2021: The Capital Markets Proclamation

The Capital Markets Proclamation has 14 parts and 113 articles that regulate the buying and selling of securities in the Capital Markets of Ethiopia.

The long-awaited proclamation has established the Ethiopian Capital Market Authority as the “autonomous government regulatory authority”.¹⁶⁶ The Authority has the objectives of

¹⁶¹ Samson Berhane, Setting-up Stock Exchange in Ethiopia, Ethiopian Business Review, 9th year, Feb-Mar 2020 No. 83, <https://ethiopianbusinessreview.net/setting-up-stock-exchange-in-ethiopia/>, last accessed June 25, 2022

¹⁶² Id

¹⁶³ Id

¹⁶⁴ A Proclamation to Provide for Dealings in Share Bonds and Other Securities, Securities and Exchange Proclamation No. ____/1995

¹⁶⁵ Draft Securities and Exchange Proclamation No. ----/2001

¹⁶⁶ Capital Markets Proclamation, supra note 5, Art. 3(1)

‘maintaining the integrity and efficiency of the market, protecting investors, and promoting the development of capital markets’¹⁶⁷, all of which go towards maintaining an orderly market.

The House of Peoples’ Representatives has bestowed upon the Authority various functions and powers to enable it to meet its objectives¹⁶⁸, including the powers to issue directives regarding all matters under its jurisdiction¹⁶⁹ and taking administrative measures for actions/omissions that are in breach of the legislations enacted to ensure the orderly functioning of the capital markets¹⁷⁰.

The Proclamation has laid the foundations for the establishment of Self-Regulatory Organisations (hereinafter referred to as SROs). SROs are non-governmental entities that have their own professional regulations and standards that they use to exercise a certain level of regulatory power over members of an industry or profession.¹⁷¹

Under the Ethiopian Capital Markets Proclamation, SROs have been defined as “entities that are recognized under this Proclamation to regulate their own members through the adoption and enforcement of rules of conduct for fair, ethical, and efficient practices in capital markets; with a view to promoting the protection of investors and the public interest.”¹⁷². Exchanges, security depository and clearing companies are among those that will be considered as SROs under the Ethiopian Capital Markets Proclamation.¹⁷³ One of such entities established under the Proclamation is the ESX.¹⁷⁴

For the first time in Ethiopian history, a securities exchange has been established by the law of the land after being deliberated upon by the House of Peoples’ Representatives. The ESX is established as a Public Private Partnership with the government holding only a quarter of the

¹⁶⁷ Id, Art. 5

¹⁶⁸ Id, Art. 6

¹⁶⁹ Id, Art. 6(1)

¹⁷⁰ Id, Art. 6(5(d))

¹⁷¹ Corporate Finance Institute (CFI), Self-Regulatory Organization (SRO),

<https://corporatefinanceinstitute.com/resources/knowledge/other/self-regulatory-organization-sro/> last accessed on May 6, 2022

¹⁷² Capital Markets Proclamation, supra note 5, Art. 2(70)

¹⁷³ Id, Art. 22(2)

¹⁷⁴ Id, Art. 31

ownership of the entity.¹⁷⁵ However, this is marred with the subsequent sub articles which provide “*if there is no interest from the private sector, the Government’s ownership of the Exchange can be increased to whatever amount is needed to establish the Exchange*¹⁷⁶” and “*if there is no interest at all from the private sector, including foreign investors, the Exchange shall be established as a fully Government owned public enterprise by regulation of the Council of Ministers.*¹⁷⁷”. These provisions might prove to be disastrous in the near future. The proclamation does not further explain what a lack of sufficient or total interest from the private sector manifests as, potentially opening up the possibility of keeping the private sector away from participation in the operation and regulation of the ESX. One may argue that the proclamation allows for SROs that have no involvement of the government and would enable the creation of a fully private SRO, however, it should be noted that one of the requirements for the recognition of an SRO is financial capacity and administrative resources that could enable it to exercise the powers delegated to it based on Art. 23 and 16(1(b) of the Capital Markets Proclamation. Based on the realities of the Ethiopian private sector, it is difficult to imagine that in the near future, the private sector could have the financial capacity to establish an SRO without the involvement of the government.

Part Twelve of this Capital Markets Proclamation, properly titled “Prohibited Trading Practices” deals with fraudulent and unethical securities trading practices that are in violation of the Capital Markets Proclamation. This part deals with unlawful or unethical practices such as insider trading (Articles 92-95), Market manipulation (Article 96), False Trading (Article 97), Fraudulent Transactions (Article 98), the Use of Manipulative Means (Article 99), False or Misleading Statements inducing securities transactions (Article 100), Front-running and other trading practices (Article 101) and other related restrictions on selling securities (Article 102). Part Twelve is supplemented by Articles 106 and 107 of the same proclamation that stipulate the offences, penalties as well as the administrative measures that may be imposed when the prohibited trading practices under Part Twelve are committed.

The following section will deal in particular with insider trading under the Capital Markets Proclamation and the offences, penalties and the administrative measures that are expected to

¹⁷⁵ Id, Art. 31(1)

¹⁷⁶ Id, Art. 31(3)

¹⁷⁷ Id, Art. 31(4)

follow the violation of the provisions dealing with insider trading as stipulated in Part XII of the Proclamation.

4.3. Legal Framework regulating Insider Trading under the Capital Markets Proclamation

It should be made clear from the onset that the Capital Markets Proclamation was recently legislated, and therefore the domestic views on the Proclamation as a whole and Part Twelve dealing with insider trading are not as developed.

Part Twelve of the Capital Markets proclamation defines the core concepts of insider trading. Insider trading in Ethiopia is defined as a prohibition of trading in securities when certain conditions are present¹⁷⁸. These conditions are the following:

1. if the value of the securities being traded are price sensitive, meaning that their value can be influenced based on inside information¹⁷⁹
2. the act of inciting another person to trade in price sensitive securities even if the incited person does not know it. This condition requires the existence of a mental element in which the inciter knows or has a reasonable basis to know that the trade would indeed occur¹⁸⁰
3. in some cases, the disclosure of a work-related information to another person where such information is not considered as a necessary information for the “proper performance of the functions of his employment, office or profession¹⁸¹”.

it is necessary to take each of the aforementioned conditions and elaborate on their elements.

The first condition under Art. 95(1) of the Capital markets Proclamation provides for a situation in which the security traded are price sensitive. Art. 93(2) of the proclamation defines “price-sensitive securities” as securities such as shares, bonds, or other types of securities whose prices or values would be materially affected if a certain inside information related to the securities are made public. Information will be considered as an “inside information” only if it is an information

¹⁷⁸ Id, Art. 95(1)

¹⁷⁹ Id, Art. 95(1(a))

¹⁸⁰ Id, Art. 95(1(b))

¹⁸¹ Id, Art. 95(1(c))

that is specifically and precisely related to the security in question¹⁸², if it is an information that is not made publicly available¹⁸³ and if it would have an impact on the value of the securities if it were made public.¹⁸⁴

The proclamation has also clarified on when information may be considered as having been made public. There are four major ways in which information can be considered as having been made public. The first is if the information relevant to the securities has been published either as per the rules provided under the directives to be enacted by the established Capital Markets Authority¹⁸⁵, or by a securities exchange¹⁸⁶ in order to inform investors or their advisors¹⁸⁷. The second way is if the information is made available on records that can be inspected by anyone in so far as such records are legally made open to the public.¹⁸⁸ The third is if the information on the securities themselves or about the securities issuer can be accessed by persons interested in trading such securities.¹⁸⁹ The fourth way is if the information about a security can be derived from another information that has been made public in one of the three ways discussed above.¹⁹⁰

Nevertheless, these are not the only situations in which information can be considered as having been made public under the Proclamation. For the purposes of the proclamation and the proper dealing of securities, even if the information can only be acquired or understood by professionals, or requires the payment of a fee to access, it will still be considered as an information that has been made public.¹⁹¹ There are also no requirements for the information to be published domestically to be considered as having been made public¹⁹². Information that can be gathered through empirical research such as observation will also be considered as information that is made public¹⁹³.

¹⁸² Id, Art. 93(1)

¹⁸³ Id

¹⁸⁴ Id

¹⁸⁵ Id, To be established as per Part III of the Proclamation

¹⁸⁶ Id, To be established as per Part IV of the Proclamation

¹⁸⁷ Id, Art. 92(1(a))

¹⁸⁸ Id, Art. 92(1(b))

¹⁸⁹ Id, Art. 92(1(c))

¹⁹⁰ Id, Art. 92(1(d))

¹⁹¹ Id, Art. 92(2(a and b))

¹⁹² Id, Art. 92(2(d))

¹⁹³ Id, Art. 92(2(c))

Insider trading would only be considered as such if the inside information as discussed in the paragraphs above is possessed by an insider who thereafter uses that inside information whilst dealing in securities¹⁹⁴.

Art. 94(2) of the Proclamation has stipulated a list of persons who could be considered as insiders with information from an inside source. This includes persons such as directors, employees or shareholders of the entity that has issued the securities, as these persons have fiduciary relationships with the company issuing the securities and have access to information that has not been or is yet to be made public¹⁹⁵. Persons that do not have a direct employment or fiduciary relationship with the company issuing the securities, however through other professional relations, official positions, or employment of another entity¹⁹⁶, and receive inside information by the virtue of this relationship are also considered as insiders. Persons who either directly or indirectly receive inside information from the insiders discussed above are also considered as insiders under the proclamation¹⁹⁷.

The crime of insider trading in Ethiopia entails a rigorous punishment, even in comparison to the international experience, of a fine and imprisonment (as shown with the conjunction “and” in both the Amharic and English versions of the Capital Markets Proclamation). By the virtue of Art. 106(9) of the Capital Markets Proclamation, the fine rests anywhere between 200,000 – 350,000 ETB and an imprisonment between 7-15 years. An insider who discloses information to another for insider trading, is liable for the same exact amount of punishment as an inside trader, as per Art. 106(15(e) of the Capital Markets Proclamation. For corporations committing these crimes, the fine goes up to 1,000,000-2,000,000 ETB¹⁹⁸. These punishments are excluding the forfeiture and confiscation of the amount the perpetrator gained from the crime.¹⁹⁹

4.4. Regulatory Framework for the protection against insider trading

¹⁹⁴ Id, Art. 94(1) cum Art. 94(1)

¹⁹⁵ Id, Art. 94(2(a)

¹⁹⁶ Id, Art. 94(2(b)

¹⁹⁷ Id, Art. 94(2(c))

¹⁹⁸ Id, Art. 106(18(d)

¹⁹⁹ Id, Art. 106(20)

4.4.1. Capital Markets Authority

A prohibitive legislative framework cannot, by itself, ensure the protection of investors and stakeholders at large from insider trading and other market abuse. Adequate supervisory and regulatory institutions should be set up to enforce and ensure that these laws are respected.

Jurisdictions around the world establish governmental or administrative bodies mandated to supervise the smooth running of the market and the protection of investors.²⁰⁰ When it comes to insider trading in particular, such governmental or administrative bodies are usually tasked with collecting the necessary information about transactions that are deemed suspicious and analysing the trading patterns and activities of suspected traders. These bodies also require the registration of persons that could be considered as insiders and assess whether there is a nexus between such persons and suspected transactions.²⁰¹

As governmental and administrative bodies, these entities have the power, not only to impose civil sanctions and take administrative or disciplinary measures, but also to seek penal sanctions by bringing cases of insider trading to a court of law.²⁰² These entities also play an educator's role as they have to ensure that investors and other stakeholders are well aware of the rules and regulations on insider trading.²⁰³

In Ethiopia, the Capital Markets Proclamation has established the Capital Markets Authority as an autonomous government regulatory authority that is only accountable to the Prime Minister, the highest executive officer of the country.²⁰⁴ This authority has been granted a wide set of powers over the country's financial market such as issuing directives on matters within its jurisdiction²⁰⁵, disseminating market information to the interested persons and stakeholders²⁰⁶ and promote education of investors²⁰⁷, and conducting regular reviews of the market to ensure its efficiency²⁰⁸.

²⁰⁰ OICU-IOSCO, *Insider Trading: How Jurisdictions Regulate It*, Report of the Emerging Markets Committee of the International Organization of Securities Commissions, March 2003, p. 15

²⁰¹ *Id*

²⁰² *Id*, p. 17

²⁰³ *Id*, p. 19

²⁰⁴ Capital Markets Proclamation, *supra* note 5, Art. 3(1 and 2)

²⁰⁵ *Id*, Art. 108(2)

²⁰⁶ *Id*, Art. 6(3(a))

²⁰⁷ *Id*, Art. 6(26)

²⁰⁸ *Id*, Art. 6(27)

When it comes to protecting the market from abuse, and in particular from insider trading, the capital markets authority has the power to monitor, both on and off site, the activities of the market and appraise all the necessary books and records that must be kept by market participants.²⁰⁹ In addition, the proclamation stipulates that this power of monitoring and surveillance also applies to “...any transaction and financial instruments traded by licensed persons and sold to the public...”.²¹⁰ In such cases, if the capital markets authority finds it necessary, it has the power to investigate all documents and question persons in any way involved or could have information.²¹¹ If such investigations find non-compliance of the various regulations meant to regulate the country’s financial market, the Capital Markets Authority has the power to take all the necessary administrative measures which could include financial penalties²¹², order a remedy, restitution or compensation²¹³, publicising of such wrongdoings²¹⁴, or suspending the licence of such persons²¹⁵. The capital markets authority may also order restriction on the title of the assets or prohibit the bank transaction of such persons²¹⁶. In cases where it finds a capital market offence, the authority may also impose administrative measures such as the suspension or revocation of licence, the dismissal of senior management personnel or the board of directors, or impose a fine on such persons²¹⁷

4.4.2. Self-regulation

Self-regulation, an inherent part of good corporate governance, can be an effective means to regulate insider trading.²¹⁸

In the Ethiopian case, as discussed above, the Capital Markets Proclamation has provided the legislative framework for the establishment of SROs, and it has subsequently bestowed upon these

²⁰⁹ Id, Art. 6(6)

²¹⁰ Id, Art. 6(6(b))

²¹¹ Id, Art. 6(19)

²¹² Id, Art. 6(5(a))

²¹³ Id, Art. 6(5(b))

²¹⁴ Id, Art. 6(5(c))

²¹⁵ Id, Art. 6(5(d))

²¹⁶ Id, Art 6(21)

²¹⁷ Id, Art. 107

²¹⁸ Sandeep Parkeh, Prevention of Insider Trading and Corporate Good Governance, Working Paper, 2003, p. 6

entities, as their naming provides, the power to regulate themselves as well as their members.²¹⁹ As a requirement for their registration and recognition, SROs need to have rules and policies to regulate the activities of the entity and its members.²²⁰ These include rules on management structures and other regulations expected to protect the rights and interests of shareholders.²²¹ There also is the need for rules to ensure the fair treatment of all members of the entity²²² as necessary rules of corporate governance. The proclamation explicitly states that the SROs need to have rules regarding “avoidance of anti-competitive practices, standards of behaviour, and investor protection and market integrity²²³”. These rules will prove to be extremely important legal frameworks for mitigating insider trading within the SRO itself.

4.4.3. Corporate governance

In many jurisdictions, good corporate governance rules have been legislated to ensure that companies are governed and controlled through the relationship of the board, management and shareholders and other stakeholders.²²⁴ As discussed under Chapter 3, the similarities of these corporate governance regulations in various jurisdictions is that they regulate directors, officers, influential shareholders to disclose or report their holding, transactions on shares or other events that have the power to impact the value of the shares, as well as to ensure the proper governance of companies and fairness to shareholders. Often good corporate governance serves as a first line of defence against insider trading.

These rules and regulations are put in place to ensure the protection of shareholders, as there is a clear asymmetry of information between them and directors, officers or influential shareholders

²¹⁹Capital Markets Proclamation, *supra* note 5, Art. 24(1)

²²⁰ *Id*

²²¹ *Id*, Art. 24(2(a))

²²² *Id*, Art. 24(2(c))

²²³ *Id*, Art. 24(2(h), (i) and (j))

²²⁴ OECD, G20/OECD Principles of Corporate Governance, OECD Publishing, Paris, 2015, p. 9

that have far better access to inside information.²²⁵ The existence of good corporate governance rules has also been found to decrease management's self-interest and acts in that regard²²⁶.

There are four fundamental standards in corporate governance. These are fairness, transparency, accountability, and responsibility²²⁷. Good corporate governance rules must be fair to ensure adequate protection of minority shareholders. They should be transparent through clear and timely disclosure of all important information. The rules should ensure accountability of all parties involved (i.e., directors, management, shareholders) by defining governance roles and responsibilities. Finally, such rules must ensure that the companies follow the legislations and the values of the country in which they are active.²²⁸

Although Ethiopia has not yet established corporate governance rules as such, the 2021 Commercial Code of Ethiopia indeed contains certain provisions on the protection of shareholders. Art. 311 of the Code requires the registration of persons that are affiliated with the company and can be considered as insiders such as, but not limited to, directors, managers, employees, officers, and auditors. The law requires that they must be registered in a register kept at the head office²²⁹, and which can be consulted by any interested persons.²³⁰ In addition, Art. 312 of the Commercial Code of Ethiopia requires that influential shareholders (holding 5% or more of the company's shares, either as individuals or with other affiliated persons or companies) disclose their ownership interest not just to the company itself, but also to the Ministry of Trade and other appropriate bodies. Shares owned by directors must also be disclosed²³¹. These rules adhere to the fundamental principle of transparency in good governance and serve as a mitigation tool of insider trading by keeping a tab on company insiders and their stake within the company.

²²⁵ Konstantin A. Rozanov, Corporate Governance and Insider Trading, Submitted to the Sloan School of Management in partial fulfilment of the requirements for the degree of Doctor of Philosophy in management at the Massachusetts Institute of Technology, September 2008, p. 20

²²⁶ Allen Hodgson, et. Al, Does Stronger Corporate Governance Constrain Insider trading? Asymmetric evidence from Australia, Accounting and Finance, Vol. 60 Issue 3, p. 2667

²²⁷Shafi Mohammed, The Importance of Effective Corporate Governance, SSRN Electronic Journal, September 2004, p. 6

²²⁸ Id

²²⁹ Commercial Code of the Federal Democratic Republic of Ethiopia, 2021, Federal Negarit Gazette Extraordinary Issue, Proclamation no. 1243/2021 (Hereinafter Commercial Code of Ethiopia of 2021), Art. 311(1)

²³⁰ Id, Art. 311(3)

²³¹ Id, Art. 313

The Commercial Code of Ethiopia of 2021 additionally stipulates the obligation of the company to keep a register at its head office including various important information regarding shareholders, the number and value of their shares²³², to keep the minutes of meetings and decisions of directors and shareholders²³³ as well as the balance sheet of the company²³⁴. This creates a fair playing ground for shareholders as they can access all the information necessary to enable them to make sound decisions regarding their interest in the company.

Articles 296-336 of the Commercial Code of Ethiopia give shareholders the power to ensure the accountability and responsibility of the management of the company by giving them the power to elect, replace or remove directors through a general meeting.

Therefore, even without corporate governance rules proper, as seen in other jurisdictions studied throughout this paper, Ethiopia indeed has, at least the minimum, corporate governance rules that can enable self-regulation by companies and in turn decrease or prevent insider trading in the securities exchange that is to be established.

Experts state that the development of a secondary market, such as the ESX, will force both existing and newly formed share companies to improve and enhance their corporate governance.²³⁵

Chapter 5 - Some Ethiopian realities that pose a challenge to the regulation of Insider Trading

It has been mentioned that a stock exchange is a secondary market, as opposed to the primary market in which share companies themselves sell certain shares of their company to raise or increase capital. In Ethiopia, let alone the secondary market that is about to be formed soon such as the ESX, even the primary market lacks proper regulation, as stated by Ermias Amelga, founder of Access Real-estate S.C²³⁶. These challenges could continue to translate as challenges in the

²³² Id, Art. 274

²³³ Id, Art. 315(6(a), 387 and 388

²³⁴ Id, Art. 441

²³⁵ Reporter Newspaper, Asrat Seyoum, ችላ የተባለው የካፒታል ገበያ, January 3, 2018, Interview with Ermias Eshetu <https://www.ethiopianreporter.com/49657/>, last accessed on September 1, 2022

²³⁶ Id

regulation of the secondary market in general and particularly as the regulations relate to insider trading.

In this section, the author will present the various challenges in the current share trading system in Ethiopia and discuss how they will challenge the regulation of insider trading.

5.1. Existing share trading culture and information asymmetry

There is a risk that the existing culture of share trading in the primary market could transpose itself to the secondary market as well. Experts state that in the current primary market, share companies often exaggerate their profits or their profitability in the prospectus they distribute to potential investors. Investors often have to focus on investigating the background and trustworthiness of the founding members and directors of the share company instead of focusing on the fiscal information or profitability of the company as stated in the prospectus²³⁷. Information, particularly material information, is at the core of securities trading. It is on the basis of that information that buyers and sellers are expected to make rational and reasonable decisions for their profit and to ensure the functioning of the market. However, the culture of withholding or even exaggerating on the prospectus will be detrimental to the securities market as a whole.

The withholding of information causes a massive information asymmetry where external, interested investors such as buyers or even those interested in selling their shares will not have the full picture when transacting on the shares. This type of information asymmetry will give the selected few, privileged insiders who have access to insider information an upper hand in making profit based on that information. However, this is precisely what insider trading rules are seeking to avoid. This is why upholding the duty of disclosure is of extreme importance.

Art. 76 and 77 of the Capital Markets Proclamation provide the duty of disclosure during two distinct periods: during the initial phase while presenting the prospectus and ongoing disclosures after the securities are issued.

Art. 76(2) provides for any prospectus issued to be “accurate, sufficiently clear, comprehensive and reasonably specific and timely”. Sub-article 5 of the same provides that this prospectus must be made freely available to the public. Art. 77 of the Capital Markets Proclamation strives to bridge the asymmetry of information by requiring companies to “as soon as reasonably practicable”

²³⁷ Id (statement from Yared Hailemeskel)

disclose material information that can affect the price of securities and that can be considered important to help investors make sound financial decisions.

Any work towards ensuring the efficiency of the ESX, or the market as a whole needs to also ensure the proper implementation of this duty.

It is also possible that the communal lifestyle of Ethiopians could potentially impact insider trading in the Ethiopian capital market. The close-knit nature of communal living in Ethiopia could make it more likely for individuals to have access to inside information. For example, individual members as part of a close-knit community, may be likely to have personal relationships with individuals who work at companies, and are considered insiders, or have access to nonpublic information. These relationships could potentially provide a source of inside information that could be used for insider trading.

5.2. Lack of adequate, knowledgeable personnel to regulate insider trading

Financial literacy in Ethiopia is at its infancy. Financial literacy is the knowledge, ability, and skills to understand and make sound financial decisions. These decisions could include “personal financial management, budgeting and investing”.²³⁸ Research shows that financial literacy in Africa in general is very low.²³⁹ With the financial system in Ethiopia still very much traditional, it has been very difficult to develop financial literacy beyond opening bank accounts and saving.²⁴⁰

In many countries, financial literacy has been very important for managing assets but also debts and liabilities.²⁴¹ It also comes in handy in ensuring the financial services sector of a country runs more smoothly and requires less regulatory and supervisory mechanisms.²⁴²

²³⁸ Jason Fernando, Financial Literacy Definition, Investopedia, <https://www.investopedia.com/terms/f/financial-literacy.asp> August 12, 2022, last accessed September 12, 2022

²³⁹ Workineh Ayalew Mossie, Understanding Financial Inclusion in Ethiopia, Cogent Economics and Finance, Vol. 10 No. 1, May 2022, p. 6

²⁴⁰ Mussie Delelegne Arega (Phd), A Clarion Calls for Financial Literacy and Numeracy in Ethiopia, The Reporter Newspaper, <https://www.thereporterethiopia.com/11950/>, last accessed September 17, 2022

²⁴¹ OECD, PISA 2012 Assessment and Analytical Framework, p. 141

²⁴² Id

The lack of financial literacy will be a major problem to the ESX and the financial market as a whole. A 2022 research published by the World Economic Forum has found that, even in countries with more developed financial sectors (the countries studied in the research were USA, France, Germany, UK, Japan, China, UAE, Brazil and South Africa), 40% of non-investing persons who were interviewed for the research stated that they do not invest “because they do not know how or find it too confusing”.²⁴³ In Ethiopia, this figure will be exacerbated due to the lack of education and financial literacy as compared to these nine countries.

Particularly, when it comes down to preventing insider trading, there are many steps that should be taken by regulatory authorities and the stock exchanges.

In most countries around the world, in order to prevent insider trading, regulators such as the Capital Markets Authority currently in establishment in Ethiopia are mandated to collect all the relevant documents and information to ensure there is no insider trading.²⁴⁴ Various regulators of capital markets also conduct sophisticated market surveillance.²⁴⁵ Analysts of regulatory authorities usually have to assess the trading and customer transaction data which could be thousands if not millions of data each day.²⁴⁶ They must additionally investigate tips and complaints sent in from various sources.²⁴⁷ All of these prevention activities however require well-trained and knowledgeable personnel that know what to look for. Investigation of insider trading has been referred to as “...a matter of putting together pieces of a puzzle”.²⁴⁸ This is because various information must be brought together to be able to see the larger picture in insider trading.

As discussed earlier, securities exchanges as SROs have an obligation to investigate insider trading. These exchanges and their employees must conduct market surveillance within the exchange. One way that exchanges have been investigating insider trading has been through

²⁴³ Madeleine Hillyer, New Study Finds Financial Educations Gaps are Primary Barriers to Retail Investing in Capital Markets, 04 August 2022, <https://www.weforum.org/press/2022/08/new-study-finds-financial-education-gaps-are-primary-barrier-to-retail-investing-in-capital-markets/> , last accessed on September 1, 2022

²⁴⁴ OICU-IOSCO, supra note 200, p. 16

²⁴⁵ Elvis Picardo, How the SEC tracks Insider trading, July 13, 2022, <https://www.investopedia.com/articles/investing/021815/how-sec-tracks-insider-trading.asp>, last accessed September 17, 2022

²⁴⁶ Medium, How Exactly does the SEC detect insider trading, <https://medium.com/geekculture/how-exactly-the-sec-detects-illegal-insider-trading-dba34f0b399b>, last accessed on September 17, 2022

²⁴⁷ Elvis, supra note 245

²⁴⁸ Medium, supra note 246

monitoring the volumes of transactions and the fluctuations of prices.²⁴⁹ This work needs trained personnel as well. These are only a few reasons why educational activities relating to insider trading are considered extremely important.²⁵⁰

Experts in Ethiopia have long been pushing the government to establish an effective intelligence system that is able to monitor the market, if it establishes a stock market.²⁵¹ Dr. Abush Ayalew, a financial consultant in Ethiopia, has stated that the lack of a well-controlled monitoring system would foster unfair competition and diminish public confidence in the system.²⁵²

Responding to the requests of experts as well as the clear need for enhancing knowledge of the financial sector and capital markets in Ethiopia, the government has had an agreement with CISI (Chartered Institute for Securities and Investment) to provide capacity building trainings for staff of various public offices, as well as interested private individuals.²⁵³ Although this move is notable, financial literacy in Ethiopia needs more than a capacity building course, but rather should be a designated course in various fields of studies, be taught at a much younger age, and be given in a more comprehensive way.

5.3. Weakness of the law enforcement and judiciary system

Another challenge in the cases of insider trading in the ESX, is related to investigation, prosecution, and final adjudication in cases of insider trading. Insider trading is one of the most difficult crimes to prosecute. It is often very hard to find the trails of the crime as we would find in murder or robbery. It is difficult to prove whether one sold or bought shares based on material, non-public information, or to prove that the information was obtained from an insider.²⁵⁴ It has

²⁴⁹ Id

²⁵⁰ OICU-IOSCO, supra note 200, p. 19

²⁵¹ Sisay Sahlu, Experts urge gov't to establish stock market intelligence system, The Reporter, April 17, 2021, <https://www.thereporterethiopia.com/11210/>, last accessed on September 17, 2022

²⁵² Id

²⁵³ Muluken Yewondwossen, Modelling the Capital Market, April 5, 2021, Capital Newspaper, <https://www.capitalethiopia.com/2021/04/05/modeling-the-capital-market/>

²⁵⁴ Knowledge at Wharton, Why Insider Trading is Hard to Define, Prove and Prevent, November 11, 2009, <https://knowledge.wharton.upenn.edu/article/why-insider-trading-is-hard-to-define-prove-and-prevent/> last accessed 21 August 2022

been stated that there is a “fine line separating legitimate information from insider information”.²⁵⁵ This increases the burden of proof to show the special character of inside information.

The most important role of insider trading rules as well as sanctions for their violation is deterring other market participants from trading in securities on the basis of non-public, material information. This plays a major role in ensuring the integrity of the market.

However, if the insider trading rules are not enforceable, then they cannot fulfil the desired deterrence goal. In jurisprudence, under the deterrence theory of sanctions, there are three necessary components: certainty, celerity, and severity. Certainty refers to the chances of the perpetrator being caught for the crimes committed. Celerity refers to the promptness of the apprehension as well as the sanctions imposed. Severity refers to the significant effect of the punishment as compared to the gains from the crime.²⁵⁶

In the case of insider trading, these three are very crucial components to ensuring the implementation of the rules. As mentioned above, insider trading is a very difficult crime to uncover, and even harder to prosecute due to the gravity of the burden of proof. Therefore, the certainty of being arrested or prosecuted could become low. This difficulty to investigate and prosecute would also make celerity very difficult in that investigations and prosecutions are bound to take a long time. Punishments for insider trading are often severe. However, as compared to the amount the traders gain from the trades, it is often minimal, especially considering that the inside trades may be done more than once before the perpetrator is found out. Therefore, any insider trading law requires the most efficient law enforcement and judiciary systems to be successful.

In the case of Ethiopia as well, considering the previously mentioned challenges of the share trading culture and information asymmetry which could potentially lead to insider trading, it is crucial to ensure the enforcement mechanisms are effective. However, with the current reality of Ethiopia, such effectiveness seems to be bleak. The capacity of the law enforcement and judicial organs to investigate, prosecute and adjudicate a crime as sophisticated as insider trading, that has not been a crime before the enactment of the Capital Markets Proclamation, is yet to be seen.

²⁵⁵ Id

²⁵⁶ Ben Johnson, Do Criminal Laws Deter Crime? Deterrence theory in criminal justice policy: A Primer, MN House Research, Jan 2019, p.4

To curb this problem, Art. 64 and following of the Capital Markets Proclamation provides for the establishment of a Capital Markets Administrative Tribunal. This tribunal will be established as an appeals court which has the power to review the procedures and decisions made by the Capital Market Authority or another body that has powers delegated to it by the authority.²⁵⁷ Decisions made by the Capital Markets Administrative Tribunal can be appealed to the Federal High Court.²⁵⁸ This takes us back to the challenge being discussed, do the courts have the capacity to entertain insider trading cases?

There is one thing that remains absolutely certain, the financial literacy courses discussed in the previous section need to be given to law enforcement officials, prosecutors, and judges of the relevant courts if the insider trading laws are expected to be properly enforced and maintain their deterrence goal.

Chapter 6 - Recommendations

The author would like to provide the following recommendations. These recommendations are categorized based on the different stakeholders they apply to.

6.1. For policy makers

- Art. 5(4) of the Capital Markets Proclamation provides that a principal objective of the Capital Markets Authority is to promote the development of the capital market by creating an enabling environment while the remaining three objectives focus on its regulatory authority. This shows a conflict of mandates, on the one hand, to develop the market and on another, to regulate it. This might lead to the weakness of the regulatory mandate, if it is seen as encroaching on the development of the capital market or due to an extremely strict regulation, lead to the underdevelopment of the capital market. There needs to be a clear mandate separation to ensure that there is a proper regulation. It is recommended that policy makers strictly follow a hybrid model including both government regulation and self-regulation. In this case, policy makers should ensure that through regulations and directives, they strengthen the capacity of the ESX and other self-regulatory organizations, which will also be valuable to developing the market. This will help ensure that the capital market authority retains its enforcement power, and develop the SROs such

²⁵⁷ Capital Markets Proclamation, supra note 5, Art. 65

²⁵⁸ Id, Art. 74

as the ESX well enough that it will be able to develop the market. Unfortunately, in various sectors in Ethiopia, self-regulation is either at its infancy or non-existent. With the capital market, policymakers have the chance to truly develop self-regulation in the country, and ensure the continued development of a capital market system that can enforce insider trading rules, among other necessary rules, for the smooth functioning of the capital market.

- Another important recommendation concerns the capacity building of the criminal justice system. Enforcement and implementation of insider trading rules is an important element of prohibiting insider trading. However, it is a challenging task. Enforcement of these rules requires the investigation and sanctioning of persons involved in insider trading, often entailing penal sanctions, therefore involves the criminal justice system. In the case of Ethiopia, there needs to be a clearly mandated organ or department within the law enforcement whose sole role is to enforce the securities laws and regulations. This enforcement organ or department needs to be well-funded and able to hire the most skilled investigators with the necessary knowledge of capital markets and prosecutors that can build successful cases, again based on their knowledge of capital markets. As it currently stands, with the absence of a securities exchange for many decades, the existence of investigators and prosecutors with the necessary skills within the Ethiopian criminal justice system is highly unlikely. Therefore, there will be a need to ensure that potential investigators and prosecutors get the necessary education. It might also be necessary to hire expert foreigners with the necessary skills and knowledge. Without adequate budget and remuneration it will be very difficult to hire persons with these high-level skills. Additionally, with the growing use of technology, it will be very expensive to ensure the surveillance systems of the regulator will be commensurate to that of the securities exchanges or the companies. It will not be a wise choice to only allow the companies or securities exchanges to only utilise technology that is also equally available to the regulator as this will negatively affect the development of the Ethiopian capital market. Therefore, the Capital Market Authority and law enforcement departments and prosecutors must be well funded. Otherwise, underfunding will definitely undermine the ability of the regulators to investigate and prosecute or take the necessary disciplinary measures.

6.2. For companies

- Although there are insider trading rules under the Capital Market Proclamation No. 1248/2021, companies need to introduce their own insider trading policies. These policies must apply to all employees regardless of their status, prohibiting any form of insider trading or tipping.

These policies must have specific provisions applying to directors, senior officials and influential shareholders, who due to their high position, could have access to or make decisions regarding material information. These policies must be comprehensive, and take into account the specific nature and structure of the company in question. The policies should stipulate the types of information that would be considered as material information for the company. It should also provide what needs to be done to consider an information has indeed been made public as per the company's policies. In this case, the company will also have to state how much time should lapse before it can be assumed that the information has been adequately disseminated to the market. This will depend on the company as well, larger companies may have a wider publicity and information regarding the company and securities could easily reach the market. It is also recommended that companies have a provision dealing with "blackout periods" and "trading windows" in their insider trading policies. A blackout period is a time when certain persons connected with a company are prohibited from entering into transactions of securities of that company. This could be because they have non-public, material information.²⁵⁹ Trading windows are the opposite of a blackout period and is a predetermined period in which company directors and employees are allowed to buy or sell securities.²⁶⁰ The insider trading policies should state how long a blackout period will last and clearly stipulate the trading windows. The insider trading policies need to also have additional prohibited trading activities when it comes to insider trading. Under Art. 95(1(a-c)) of the Capital Markets Proclamation, the prohibited acts are trading based on the material, non-public information, encouraging another to trade based on that information or disclosing or tipping such information to another. However, there must be additional provisions in the insider trading policies of the company such as compliance with blackout periods, and prohibitions on giving advice about the company or even in some cases responding to or addressing speculations about the company or its securities on any media or medium, to anyone. These last two added prohibitions go to the core of the Ethiopian share trading culture, where investors often ask advice from company employees about the success or failures of the company and its profitability. Insider trading policies should also contain provisions on how to report insider trading and provide for the establishment of a compliance office that is mandated to investigate and determine violations and take the necessary disciplinary measures.

²⁵⁹ <https://www.investopedia.com/ask/answers/08/blackout-period.asp>

²⁶⁰ <https://www.mystockoptions.com/glossary/index.cfm/objectid/F8C1397C-BF3C-407C-A06D280339935783>

- As has been stated in section 4.2.3. above, often corporate governance is the first line of defence against insider trading. Companies in Ethiopia should also develop their own corporate governance rules that go above and beyond the minimum stipulations found under the 2021 Commercial Code of Ethiopia. The corporate governance rules should at least consist of the following. It should consist of a clear company structure outlining the roles and responsibilities of each person in the structure. It should also have a code of conduct that must be adhered to by the board of directors, management, employees or other involved parties such as auditors or advisors. The corporate governance rules should also include best practices and mechanisms designed for the management of corporate risks that may have negative impacts on shareholders, investors and the business community at large - such as insider trading. There should also be specific rules on the clear designation and disclosure of corporate information, as this is often one of the most important factors in insider trading. The corporate governance rules should also have rules on the remuneration of the board of directors and the revision procedures of such remunerations. In addition, there must be specific rules on the auditing of the books and accounts of the company. there should also be clearly stipulated rules on transparency and accountability. The corporate governance rules should have the rights of shareholders and key stakeholders at the centre and ensure fairness while safeguarding the rights of such persons.

6.3. For the general public

The ESX, and the Ethiopian capital market as a whole is expected to also raise money from Ethiopians who are just keeping their money in the savings accounts of banks, not just from external or foreign sources. As such, investor education is critical to achieve the necessary level of financial literacy that would enable potential investors to make informed decisions. With regards to preventing insider trading, this researcher recommends that there be a focus on investor education on the following areas of financial literacy.

- The first is investor education focused on ensuring the general public, which includes potential investors, know the insider trading rules and regulatory framework under the Capital Markets Proclamation and other legislations. It is not enough to merely distribute the printed version of the Negarit Gazette. There need to be dedicated publications in pamphlets, brochures, and various newspapers, broadcasts on television and radio, as well as on social media to ensure that the general public understands the prohibition of insider trading, what non-public material information is and the sanctions applicable to the violation of the prohibition. This is especially

important to counteract the existing share trading culture in Ethiopia which rests on receiving information and advice about the company, its securities and profitability from company insiders. This awareness raising campaign should be conducted continuously for a long time to ensure that the public has adequate knowledge regarding insider trading.

- The second focus of investor education should be on awareness raising on the enforcement of insider trading rules. The reason that insider trading cases in the jurisdictions analyzed in the comparative study of this paper are sensationalized and publicized is to ensure that the general public knows insider trading, advising, or tipping based on material, non-public information will be prosecuted and punished. The visibility of the enforcement of the insider trading laws will be very important in fulfilling the desired deterrence goal. Insider trading cases should be well reported in the mainstream and social media. This will help in raising awareness regarding the certainty of the enforcement and the celerity of the sanctions for the violation of insider trading rules.

Chapter 7 - Conclusion

Ethiopia finally took the economic leap that many experts have been pushing for decades. The country is establishing the ESX. The establishment of this secondary market has been desired by many that hope to see a boom in the Ethiopian economy through the raising and increasing of capitals into share companies, and fund raising for small and medium sized enterprises. Soon enough, the unstructured secondary market and the difficulties in buying and selling of shares will become much easier and more efficient, or so we hope.

The financial market in general, and securities exchanges in particular are very much susceptible to financial crimes that have the potential of disrupting the entire economy of not just the host country, but even cause an international economic crisis. Insider trading is one of such crimes. Insider trading is the act of using unpublished (non-public) information that is material – having the potential of affecting the price of securities – to buy or sell securities in the capital markets.

One may question what the problem is? Financial trading is a game of using all the information one has and making the most informed, rational decision on its basis.

However, the financial market is built on trust. Trust that everyone gets the same information, some will then use their advanced academic backgrounds and expertise to analyse that information.

Insider trading, therefore, causes an imbalance in the playing field in favour of the one with inside information, as not everyone gets the same information.

Non-public material information allows privileged investors that receive that information a chance to make profits or avoid losses from the capital market ahead of all other market participants and at their expense. One of the worst consequences of insider trading, in addition to the financial crisis it can cause, is undermining the public confidence in the capital market and the financial markets at large. There will be less people investing due to the lack of trust and therefore the capital raising, and economic development goals expected from the market will not be gained.

For these reasons, many jurisdictions around the world have enacted rules and enforcement measures against insider trading. Countries like the US, UK, India, Nigeria, and Kenya – studied in the present paper - have rules prohibiting insider trading, detailing the core components, setting up the penalties for violations of the prohibition as well as determining the duties of the bodies responsible to ensure the respect of the rules, such as the regulatory authorities, self-regulatory organisations (SROs) and companies themselves.

The case in Ethiopia has not been different. Proclamation No. 1248/2021, the Capital Markets Proclamation explicitly prohibits insider trading under Art. 95, providing rigorous punishments under Art. 106 in case of contravention of such prohibition.

Now, the question becomes, does the mere existence of the laws deter insider trading? Insider trading is a very sophisticated crime that is often hard to notice, investigate and prosecute. It is often difficult to know the difference between a securities transaction made through knowledge and tracking through the available financial information from a transaction made through inside and non-public material information. The fact that it is not a crime that leaves trails and footprints makes it much more difficult to investigate. The mens rea required for the crime of insider trading in Ethiopia, particularly when sharing insider information for example, is very high stating *“encourage[ing] another person, whether or not the other person knows it, to deal in securities or their derivatives which are price-sensitive in relation to the information in possession of the insider, knowing or having reasonable cause to believe that the dealing would take place”*. The intent and knowledge here require a very high burden of proof. It should be noted that, as a criminal act, the burden of proof required is that of *“beyond a reasonable doubt”*.

As if proving insider trading in itself is not difficult enough, there are some Ethiopian realities that exacerbate that challenge. The current share trading culture in Ethiopia is based on knowing and trusting the founding members and managers of companies, as opposed to trusting the prospectus. This is because documents such as the prospectus and financial reports, with the exception of reports from financial companies such as banks, insurance, and microfinance institutions, often exaggerate profitability. Information is also withheld from the prospectus creating an information asymmetry that leads to insider trading.

Another problem is the lack of knowledge. Financial literacy in Ethiopia is at its lowest and it is close to none when it comes to the knowledge of the functioning of a securities market. A third challenge which is very much connected to this challenge is the weakness of the law enforcement and judiciary when it comes to investigating, prosecuting, and adjudicating financial crimes as sophisticated as insider trading.

The proclamation has provided for the obligation of disclosure of all necessary information relating to a security both in the prospectus and ongoing disclosures as well, which help in ensuring managers and founders do not exaggerate or withhold the necessary information. There have also been some capacity building activities through short courses on financial markets for public officials and interested persons. The proclamation has also provided for the establishment of a specialised Capital Market Administrative Tribunal that will deal with decisions made by the authority.

To what extent these solutions will prevent the risk of insider trading in the ESX, is something that we can truly determine after the establishment and functioning of this secondary market in Ethiopia.

However, the ultimate goal is to ensure that the crime of insider trading is not committed. The best way to ensure that is to conduct aggressive educational campaigns, not just short-term courses, to everyone, even those who are remotely interested in finances. It is also recommended to focus on education at a much younger age.

The author of this paper has presented the aforementioned major challenges that the Capital Market Authority, an SRO such as the ESX and companies themselves could face with regards to insider trading. In doing so the author has detailed the core concepts of insider trading, the insider trading

laws in various jurisdictions around the world as well as those of Ethiopia. The regulatory frameworks present in the Capital Markets Proclamation of Ethiopia and other laws such as the Commercial Code of Ethiopia have also been addressed in the present paper.

Finally, the author has put forward six recommendations in the final section, that will help strengthen and ensure the enforcement of the insider trading laws in Ethiopia. For policymakers, this author recommends that, although a hybrid regulation is preferred, there needs to be a clear separation of mandates between the Ethiopian Capital Markets Authority and the SROs such as the ESX, with the SO bearing the major task of developing the capital market. Additionally, policymakers need to ensure better investment for capacity building of the criminal justice system to enable it to adequately perform its investigative, prosecutorial and judicial roles in the prevention of insider trading. For companies, it is recommended that they enact internal insider trading policies and corporate governance rules that define the core concepts of insider trading, personnel that would be considered insiders, disclosure of information and all other crucial elements, which would ultimately serve as the first line of defense to prevent insider trading. Finally, for the general public, the author recommends that there need to be aggressive awareness raising campaigns to ensure that the general public is well aware of the insider trading rules in Ethiopia and the sanctions that would follow the violation of these rules.

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