

CHAPTER EIGHT

CONCLUSIONS AND RECOMMENDATIONS TO SOLVE THE INSIDER TRADING PROBLEM IN SOUTH AFRICA.

8.1. GENERAL OBSERVATIONS.

While the attempt made by the legislature to improve the insider trading legislation by replacing the Insider Trading Act, 135 of 1998 (the 1998 Act) with the Securities Services Act, 36 of 2004 (the New Act) was commendable, previous flaws were repeated¹ and new ones were unfortunately introduced.² It is clear from the previous discussion, specifically in Chapter 4, that the legislature's good intentions with the adoption of the New Act are not also reflected in an increase of prosecutions and claims being resolved or settled.³

This Chapter seeks to recommend possible solutions to the insider trading problems in South Africa. It is hoped that such recommendations will help the legislature to succeed in its insider trading regulatory endeavors and to ensure that insider trading legislation is put in place that is comparable to the international best practices, to protect and attract investors.

¹ See Jooste R "Insider Dealing in South Africa" (1990) 107 *SALJ* 588; Luiz S M "Prohibition Against Trading on Inside Information – The Saga Continues" (1990) 2 *SA Merc LJ* 328; Botha D "Control of Insider Trading in South Africa: A Comparative Analysis" (1991) 3 *SA Merc LJ* 1; Jooste R "The Regulation of Insider Trading in South Africa – Another Attempt" (2000) 117 *SALJ* 284-305 and Osode P C "The new South African Insider Trading Act: Sound law reform or legislative overkill?" (2002) 45 *Journal of African Law* 239–248.

² Jooste R "A Critique of the Insider Trading Provisions of the 2004 Securities Services Act" (2006) 123 *SALJ* 437.

³ *Ibid.*

8.2. RECOMMENDATIONS.

A number of recommendations aimed at resolving the insider trading problem are made with suggestions explaining how these recommendations can be best utilized to curb insider trading and related prohibited practices.

- (i) *The researcher recommends establishment of separate and specialist courts for insider trading manned by experts in the relevant fields.*

The purpose is to address the concerns about the small number of cases that are successfully resolved.⁴ Many cases have probably been abandoned due to the suspected incompetence of the officials of the courts on matters that relate to insider trading.⁵ Delays and the everlasting backlog in the courts aggravates the situation.

The researcher therefore recommends the immediate establishment of specialist courts for insider trading cases on a regional basis or at least in each center where there is a division of the High Court of South Africa.

A judge who presides over insider trading cases may not always be a specialist in corporate law and securities trading. This may cause unnecessary delays, judgments that are open to criticism and if the prosecutors are not specialists, even withdrawal or abandonment of cases. It is therefore peremptory that these courts like in Canada and Australia⁶ be administered by persons who have adequate and appropriate knowledge and expertise.

⁴ See Crotty A “First Insider Trading Case goes to Court” *Business Report* 19 October 2001 *Sunday Times* 26 January 1997 25. Also see Osode P C “Defending the Regulation of Insider Trading on the Basis of Sound Legal Orthodoxy: The Fiduciary Obligations Theory” in Okpaluba C (ed) *Law in Contemporary South African Society* (2004) New Africa Books 303 and Jooste R *op cit* note 2 437.

⁵ See Chapters 3 and 4 of this dissertation.

⁶ See Chapters 6 and 7 of this dissertation respectively.

- (ii) *The insider trading regulatory framework should not be rigidly based on the policy goal of deterrence alone.*

Although the policy goal of deterrence adopted by the legislature is very important, it should not be the only method of combating insider trading and related practices. Other policy goals such as detection and prevention of insider trading activity in securities markets and companies as well as other relevant institutions should be adopted as well. Severe penalties in the form of fines and long terms of imprisonment are necessary as is civil liability to compensate victims. This, however, has to be supported with proper preventative measures to discourage insider trading and related activities. Furthermore, regardless of how deterring penalties for insider trading might be, if insider trading activity is not detected in time and if action is not taken, some persons will always escape liability.

- (iii) *The researcher recommends adequate awareness and education of insider trading offences to all relevant persons.*

Awareness and educational strategies are important to ensure that the public is aware of their rights and potential perpetrators of the effects of insider trading activity.

Apart from the insider trading manual (booklet) which was published by the Johannesburg Securities Exchange (JSE) at the request of the Minister of Finance, there are no other measures taken to make the public and the relevant shareholders or institutions aware of these matters.

Effective publicity campaigns even at grassroot level, and development of adequate curricula comprising securities trading for teaching at both secondary and tertiary levels in South Africa can be considered to be essential, for purposes of imparting knowledge about lawful and unlawful trading in securities.

- (iv) *The legislature should consider adopting other non statutory measures such as incentives to encourage persons and institutions to disclose price-sensitive information relating to securities and to report incidences of insider trading timeously.*

In addition to adopting measures that are implemented in some highly respected jurisdictions such as Australia,⁷ the legislature should consider to encourage every possible incentive such as whistle blowing without fear of reprisal.⁸ Moreover, companies and relevant institutions should be encouraged to promote strong ethical compliance and a culture that encourages anti-insider trading practices such as whistle blowing. Furthermore, companies must be discouraged from ignoring whistle blowing or from dismissing employees who speak or reveal possible insider trading activities.

Companies and institutions must therefore be encouraged to develop adequate internal mechanisms to minimize insider trading. These will include arrangements like Chinese Walls and mandatory reporting obligations on the part of all their employees, to report any abuse of unpublished price-sensitive information relating to securities or other financial instruments. This may also encourage them to develop their own policies on timeous and accurate dissemination of information to the public.

- (v) *The researcher recommends the enactment of adequate defences for insider trading.*

The New Act creates five offences that may be committed by an insider who knowingly abuses the unpublished price-sensitive inside information and fails to prove any of the proscribed defences on a balance of probabilities. The defences however, turned out to be inadequate⁹ and are often difficult to prove on a balance of probabilities.

⁷ See the analysis in Chapter 7 of this dissertation.

⁸ This is clearly reflected in the insider trading regulatory frameworks found in some respected jurisdictions notably, the United States of America and Canada. See Chapters 5 and 6 of this dissertation respectively.

⁹ See paragraph 4.6.3 in Chapter 4 of this dissertation for further analysis.

This created the risk of the provisions of the Act being perceived as draconian and of over criminalization of the insider trading offence, to cover innocent remarks or disclosure of price-sensitive inside information without the intention for such information to be acted upon by others.

The researcher recommends the addition of a Chinese Wall defence to protect bigger companies or institutions that developed and have successfully maintained measures to restrict the flow of information between departments.¹⁰

The researcher also recommends enactment of defences for persons who are *coerced* or *forced* to trade in any listed securities, for instance where directors for the purpose of not drawing the attention to themselves, force employees to buy or sell securities to avoid the risk of them being dismissed. Where this results in insider trading, a defence should be made available to the employees.

Lastly, like the Canadian and Australian experiences, the legislature should consider enacting specific exceptions to supplement the proscribed defences, to avoid accused persons from being liable unjustifiably.

(vi) *The researcher recommends different penalties for insiders (individuals) and institutions (juristic persons) and for the various offences.*

This entails different penalties firstly, for insiders who violate insider trading provisions for their own benefit or for the benefit of others and secondly, for tippees and thirdly, for persons who discourage or encourage others to deal in securities or who disclose price-sensitive inside information to others. Lastly, there must be a distinction between the penalties imputed on individuals (natural persons) and those imputed on companies or institutions (juristic persons). The maximum fine for a company should be substantially

¹⁰ As is the position in Australia - see paragraph 7.2.6 in Chapter 7.

increased¹¹ and conviction of the company or juristic person should not exclude prosecution of its directors, managers or employees who were involved.

(vii) *The researcher strongly recommends the adoption of mandatory disclosure (duty to disclose) requirements for companies and all issuers of securities in the New Act.*

The New Act like its predecessor (the 1998 Act), did not provide for mandatory duties of disclosure of inside information for companies and issuers of securities. Unlike in other developed countries such as Australia,¹² the South African legislature seems to have ignored the importance of prompt disclosure of inside information. As stated by Jooste,¹³ a mandatory duty on the part of companies and issuers to disclose their transactions relating to listed securities has meaningful advantages.

Firstly, it reduces the opportunities for insider trading activities.¹⁴ Secondly, it gives all persons equal opportunities to trade on the basis of disclosed price-sensitive information (the equal access to information benefit). Thirdly, it will ensure that the South African insider trading legislation is internationally comparable to that of countries like Canada¹⁵ and Australia.¹⁶ Fourthly, as argued by Jooste, “a mandatory disclosure requirement increases the pool of information on which market analysts can draw in updating their

¹¹ See Jooste *R op cit* note 2 453.

¹² For a detailed discussion, see Chapter 7 of this dissertation.

¹³ See Jooste *op cit* note 2 452.

¹⁴ See Osode P C *op cit* note 1 256.

¹⁵ In the Canadian legislation, the term “timely disclosure” is often used to constitute a mandatory obligation for companies and other issuers of securities to disclose their price-sensitive information relating to securities within the stipulated or reasonable time.

¹⁶ In the Australian regulatory framework, the term “generally available” is used with regard to a mandatory duty of disclosure requirement, imposed on companies and other issuers of securities to disclose their price-sensitive information within the stipulated or reasonable time.

assessments and forecasts of corporate performance thus enhancing the efficiency of the market”.¹⁷

Disclosure requirements similar to those in the JSE disclosure requirements and SRP rules can be considered to be introduced to impose a duty on all companies or institutions to disclose without delay, any negotiations towards any transaction that is likely to have a material effect on the price of its securities or financial instruments. Public notice in a newspaper circulating in the Johannesburg area, newspapers circulating the area where the company or institution’s registered office or principal place of business is situated, to Reuters, the South African Press Association and through the Stock Exchange News Service (SENS) may be advisable.

Although there was no room to discuss the JSE mandatory disclosure rules (which are internal rules of the JSE Ltd and not statutory principles) in detail in this dissertation, it must be noted that the Securities Services Act itself does not impose a duty of disclosure on the JSE, to report suspected insider trading activity, or unusual movements in the prices of securities, or unusual trade volumes. A statutory duty on the JSE to report these matters to the DMA may enhance co-operation between the JSE and the FSB.

It is generally agreed that the policy makers should provide for an adequate mandatory disclosure requirement coupled with appropriate criminal sanctions for companies or issuers who deliberately fail to comply with such a requirement.¹⁸

(viii) *The legislature should consider providing a direct right of action to issuers of securities as well as to aggrieved investors.*

The New Act does not clearly provide for a right of action to issuers of securities. Unlike the position in Australia, where offenders are liable to compensate the actual person

¹⁷ See Jooste R *op cit* note 2 453.

¹⁸ See Osode P C *op cit* note 1 256.

affected by a particular insider trading transaction, such action is not clearly provided for in South Africa. The researcher also submits that affected issuers, in addition to lodging their claims with the FSB, should have the option to claim *directly* from convicted offenders if there is no surplus left in the account of the FSB or if no civil proceedings were instituted by the FSB and after having given notice to the FSB.

- (ix) *Companies must have internal regulatory measures (mechanisms) that prohibit and discourage insider trading.*

If companies have in place adequate internal self-regulatory systems or mechanisms to combat insider trading, it may cause the financial markets and the securities industry to be more competitive in today's global economy which is characterized by vast technological advancement. The researcher recommends that for this reason and others that were stated previously, companies should be encouraged to have their own internal frameworks in place and they should be encouraged by the legislature to do so.

- (x) *The legislature should consider engaging other regulatory bodies apart from the Financial Services Board (FSB) for the purpose of improving the effectiveness of the enforcement.*

Unlike in Australia, where the enforcement of the insider trading prohibition involves many regulatory bodies,¹⁹ this is the responsibility, only of the FSB and its functionaries. Although the courts have a part to play in the enforcement of the insider trading ban, it is submitted that there appears to be too little co-operation and coordination between the FSB and the courts.²⁰ Other relevant regulatory bodies such as Bond Exchange of South Africa (BESA) should become more involved in complimenting the efforts of the FSB. This will help the public regulator (FSB) to raise adequate resources for effective enforcement of the insider trading prohibition.

¹⁹ See paragraph 7.2.7 in Chapter 7 of this dissertation.

²⁰ See paragraph 4.6.3 in Chapter 4 of this dissertation.

(xi) *Enactment and adoption of less stringent methods of prosecuting insider trading cases.*

The unsatisfactory state of affairs in relation to the number of prosecutions and of settlements²¹ can largely be addressed by adoption of streamlined procedures for prosecution of the insider trading cases such as reducing the evidentiary burden of proof on the FSB and affected investors in civil cases. The researcher recommends further that the rebuttable presumption relating to the requirement of knowledge that was formulated in Chapter 4.2.2 be included in the New Act. It is hoped that this action will also help the Directorate for Market Abuse (DMA)²² to secure more settlements.

Moreover, with respect to both criminal and civil cases, it is inherently difficult to establish whether the accused person knows that he has inside information since in many instances the facts (circumstances) to be established depend on the relevant court's discretion.²³ Henceforth, the researcher recommends that the courts should not be allowed to *rigidly* rely on the *requirement of knowledge* alone in order to impute liability on any accused persons. Instead, courts should be empowered to adopt a flexible approach that incorporates other less stringent methods such as exceptions or rebuttable presumptions as discussed herein.

(xii) *The legislature should consider adopting a more restricted and practically enforceable approach to combat insider trading.*

Unlike the position in Canada²⁴ and Australia,²⁵ the insider trading prohibition enjoys unlimited extra-territorial application in terms of the South African legislation but is

²¹ See authorities quoted in note 4.

²² The functions of the DMA are well elaborated in Chapter 4 of this dissertation.

²³ See Jooste *R op cit* note 2 442.

²⁴ Refer to Chapter 6 of this dissertation for more explanatory and detailed study.

²⁵ See paragraph 7.2.2 in Chapter 7 for further analysis and more elaborate discussion.

ineffectively enforced because of limited financial resources. A more restricted and practically enforceable approach having a territorial basis is recommended.²⁶

(xiii) *The government and all relevant stakeholders should be fully involved and be supportive in relation to the regulation and enforcement of the insider trading prohibition.*

Only the FSB is directly involved in the enforcement of the insider trading ban. Apart from more involvement of other relevant regulatory bodies such as BESA and specialized units that investigate economic offences, the researcher recommends that government should put in place additional specialized units to prosecute insider trading and be directly involved in the actual enforcement in the courts of the provisions relating to civil liability. The FSB could then be left with the responsibility to monitor market tendencies that may point towards insider trading activity and engage other bodies to investigate, prosecute and litigate. The FSB, with the assistance of the DMA and the EC, should concentrate on the initial monitoring function, out of court settlements where justified and administration of claims by the aggrieved investors.

(xiv) *The policy makers should consider developing an adequate and effective corporate ethics culture that will be observed in companies and financial markets of South Africa.*

This relates to market professionals, such as brokers, financial analysts, lawyers, accountants and also publishing and printing companies in South Africa. It would be misleading to argue that these persons have nothing to do with the regulation of insider trading. These role players often have access to unpublished price-sensitive information in the course of executing their duties and ample opportunity to engage in insider trading activities. Administrative sanctions such as forfeiture of licences, suspension from profession or disqualification to serve as directors should also in this context, be

²⁶ See Jooste R *op cit* note 2 453; paragraph 4.3.1 in Chapter 4.

considered by the legislature to promote such a strong corporate and professional ethics culture.

Furthermore, the researcher recommends effective programmes based on best organizational culture of companies and other institutions.²⁷ Such programmes could include developing effective anti-corruption measures and strategies, proper record keeping of compliance and adequate and effective auditing. The researcher recommends that the *company secretary* should be specifically responsible to the company for compliance with insider trading legislation and the internal regulatory framework of the company

(xv) *Introduction of an offence of attempted insider trading.*

Instances where an individual deliberately and intentionally discloses non public price-sensitive inside information to another person who somehow, does not trade or deal in relation to it is an offence. The same should be the case if any person attempts to purchase or sell or otherwise to benefit from unpublished inside information as such.

(xvi) *A complete repeal of the current provisions or alternatively an amendment thereof.*

The South African insider trading legislation is flawed and inadequate, both in its content and application²⁸ and insider trading is still a concern in regulated markets and listed companies as well as unregulated financial markets. The researcher therefore recommends a complete repeal of the current provisions or alternatively, a complete revision thereof so that they will be applicable to all financial markets, companies, other bodies and relevant persons.

²⁷ See also Berenbeim R E “The Enron Ethics Breakdown” (Feb 2002) 15 *Executive Action* 5 <http://www.conference-board.org> 10 October 2006.

²⁸ This includes a substantial number of terms that are not adequately defined - see paragraph 7.2.1 in Chapter 7. Also see Jooste R *op cit* note 2 445.

8.3. CONCLUDING REMARKS.

There can be no doubt that the enactment of the New Act was a positive attempt by the legislature to improve the adequacy and enforcement of the insider trading provisions in South Africa. However, considering the many shortcomings of the New Act as outlined in this dissertation, it is clear that such an attempt was to a large extent unsuccessful.²⁹ It was pointed out in this research that many of the flaws found in the 1998 Act were repeated, sometimes even with the addition of the new ones. For this reason, it is recommended that the existing legislation be revised comprehensively with regard to the recommendations made in this research. It is hoped that this dissertation will make a *meaningful* contribution towards *combating* insider trading in South Africa.

²⁹ Refer to Chapter 4 of this dissertation for more information.