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Survey of National Legislation Regulating Insider Trading

Mary J. Houle*

INTRODUCTION

In recent years much attention has been focused on the phenomenon of "insider trading." The United States Securities and Exchange Commission (SEC) now appears to have wide-spread public support for its hard-line approach toward insider trading practices. Previously hostile to a broad prohibition of insider trading, even the Supreme Court has lent a sympathetic ear to the pleas of the SEC in the recent *Carpenter* case, which hinted at support for the misappropriation theory of insider trading.¹ The prevailing attitude is that confidence in the fair operation of the securities markets must not be undermined by insiders who deprive those trading "fairly" from earning a profit; insiders must not be allowed to appropriate information in order to gain unjust enrichment.

The U.S. securities exchanges are increasingly affected by foreign investors who trade on the U.S. exchange markets. The SEC considers cooperation by foreign governments and individuals vital to the successful implementation of U.S. insider trading regulations. In part as a response to pressure from the U.S. government, many governments around the world have enacted or are now considering new insider trading legislation.

I. THE EUROPEAN COMMUNITY

A. Governing Statute

Since May of 1987 the Council of the European Community has been considering a proposed directive concerning the regulation of insider trading.² The

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1. *Carpenter v. United States*, 108 S. Ct. 316 (1987).

2. Proposition de directive du Conseil concernant la coordination des réglementations relatives aux opérations d'initiés, COM(87) 111 final, J. O. Comm. Eur. 87/C 153/69.

Council recently submitted it to the European Parliament and to the Economic and Social Committee for comment. The proposal will in all likelihood be discussed by the Council in the latter half of 1988.

The Council's proposal stresses the importance of securities markets and the value of investor confidence in securities exchanges. It notes that this confidence depends on placing all investors on an equal footing. Since many European countries do not yet prohibit insider trading, and since considerable differences exist among those which do prohibit it, the proposed directive calls for coordinated regulation of such practices. Cooperation would facilitate regulation by combining powers of authorities in the different countries to prevent insider trading across national boundaries.

B. Definition of Insiders

Article 1 of the proposal directs all European Community members to prohibit persons, who in the exercise of their profession or functions obtain knowledge concerning privileged information, from utilizing confidential knowledge which concerns securities bought and sold on public stock exchanges.

Member states will be instructed to impose the prohibition contained in article 1 on all persons who have obtained privileged information (tippees) from one who acquired that information in the exercise of their profession or function.

C. Regulated Information

Privileged information includes information which is not publicly known concerning one or many securities of publicly traded corporations which, if made public, would be capable of influencing the trading of those securities on the market.

Those issuers of securities, admitted on the official stock lists of one or more member states or which are negotiated on another stock exchange must inform the public of the involved member states, without delay, of all decisions capable of influencing the trading course of those securities. There may be legitimate reasons for not disclosing privileged information. In order to avoid the obligation of disclosure in such cases, the competent authorities must be informed of the information and of the need to maintain confidentiality.

D. Regulated Transactions

The prohibition does not apply to securities bought or sold outside of the securities exchange if a professional intermediary has not intervened. These securities include not only those normally negotiated on public exchanges, but also negotiable options.

Those who have access to privileged information are forbidden from:

1. communicating that privileged information to a third party if it is not communicated in the exercise of their profession or function; and
2. recommending to a third party, on the basis of that privileged information, to buy or sell securities negotiated on their public exchange.

E. Punishment and Sanctions

The proposed directive includes no sanctions, although the European Community might establish guidelines for sanctions at some future time. As now drafted, the proposal will allow the individual member states to determine their own civil and/or criminal sanctions under their national laws.

F. Conclusion

The proposed directive may or may not be adopted in the foreseeable future. While the proposal itself carries no authoritative weight, it does indicate that member states are concerned with insider trading.

The directive recognizes that many states have secrecy laws, especially in banking regulations. Nonetheless the authorities should be notified of confidential, price sensitive information. The authorities may use such knowledge only in their specific administrative or jurisdictional procedures, thus maintaining the integrity of the secrecy laws.

II. GREAT BRITAIN

A. Governing Statute

The Company Securities (Insider Dealing) Act 1985 serves as the primary statute regulating insider trading.

The Financial Services Act 1986 also regulates insider dealing in Part VII by modifying parts of the Company Securities (Insider Dealing) Act 1985.

B. Definition of Insiders

Section 1 of the Company Securities (Insider Dealing) Act 1985 defines insiders as all individuals who are, or at any time in the preceding six months have been, knowingly connected with a corporation, or one related to it.

Under section 1(3), tippees who knowingly obtain information, either directly or indirectly, from an insider are prohibited from dealing on a recognized stock exchange in securities of that company if they know that the information is unpublished price sensitive information relating to those securities. Tippees are prohibited from trading in securities of other corporations if they know the information is unpublished price sensitive information and that it relates to any

factual or contemplated transaction involving the first company and the other company, or involving one of them and the securities of the other, or to the fact that any such transaction is no longer contemplated. This section is specifically aimed at tender offers and take-overs. *Scienter* is an essential element for all insider liability.

Crown servants are prohibited from using or transmitting inside information for gaining a profit or avoiding a loss. The Financial Services Act 1986, section 173 extended liability to public servants as well. Public servants include, among others, members or servants of any authority or transferee body, members of self-regulating organizations or recognized investment exchanges or recognized clearing houses. Section 173(5), also provides that the Secretary of State may by order declare any member, officer, employee, or individual connected with any group who appears to exercise a public function to be a public servant if he has access to unpublished price sensitive information relating to securities.

C. Regulated Information

Section 1 prohibits insiders from dealing on a recognized stock exchange in securities of a company if they have information which:

1. is held by virtue of being connected with the corporation;
2. if it would be reasonable to expect these persons not to disclose that information except for the proper performance of their functions attaching to that position; and
3. if they know it is unpublished price sensitive information in relation to those securities.

Section 2 forbids individuals, who are or have been at any time in the preceding six months, knowingly connected with a corporation from dealing in securities of any other company if they obtain information by the following means:

1. information held by virtue of their connection with the first company;
2. if it would be reasonable to expect them not to disclose that information unless in the proper performance of their functions;
3. if they know the information is unpublished price sensitive information in relation to those securities of that other corporation; and
4. if it relates to any actual or contemplated transaction involving the two corporations.

Section 10 defines “unpublished price sensitive information” in relation to any securities of a company as information which directly or indirectly relates to specific matters of concern to that company and is “not generally known to those persons who are accustomed or would be likely to deal in those securities, but which would if it were generally known to them be likely materially to affect the price of those securities.”

D. Regulated Transactions

Individuals to whom the sections apply are prohibited from dealing, counselling others to deal, and communicating the information to any other person.

Individuals are not prohibited from:

1. doing any particular thing other than with a view to making a profit or avoiding a loss for himself or a third party by the use of that information;
2. entering into a transaction in the course of the exercise of good faith of one's functions as a liquidator, receiver or trustee in bankruptcy; or
3. doing any particular thing if the information
 - a. was obtained by him in the course of a business of a jobber (individual, partnership, or company dealing in securities on a recognized stock exchange) in which he was engaged or employed,
 - b. was of a description which it would be reasonable to expect him to obtain in the ordinary course of that business, and
 - c. he does that thing in good faith in the course of that business.

Section 5 states that those prohibited under sections 1 and 2 are forbidden from counseling or procuring any other person to deal in those securities if the tipper has knowledge or reasonable cause to believe that the tippee would deal in the securities outside Great Britain on any stock exchange other than a registered stock exchange. These persons are further prohibited from communicating that insider information to any other person if they know or have reasonable cause to believe that that person or another party would take advantage of the information in order to deal, or to counsel or procure any other party to deal, in the securities outside Great Britain on any stock exchange other than a registered stock exchange.

Dealing in international bonds and debentures, however, are excluded under section 6 from the prohibitions described above if certain conditions are satisfied. They must be:

1. dealt with in good faith; and
2. the party must be an issue manager for that issue or an officer, employee or agent of an issue manager for that issue; or
3. the party is or was an issue manager for an international bond issue who is making a market in that debenture or right; or
4. the party is an officer, employee or agent of such an issue manager and deals in good faith as one making a market in that debenture or of right as an officer, employee or agent of such a person.

E. Punishment and Sanctions

1. Civil

No civil penalties are provided for a violation of this statute.

2. *Criminal*

Those who contravene the rules are liable under section 8(a) upon conviction on indictment to imprisonment for a term not exceeding seven years or a fine, or both, and under (b) on summary conviction to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both.

The Secretary of State institutes all proceedings or the Director of Public Prosecutions gives his consent.

III. IRELAND

A. *Governing Statute*

The Irish Government passed an Explanatory and Financial Memorandum, Companies (No.2) Bill 1987, in order to strengthen some of the existing provisions of the Companies Act, 1963. The applicable provisions are located in Part V of the Bill, including sections 90 through 93. The bill introduces some new measures which aim to "eliminate, deter or penalize certain abuses and malpractices which can occur in the management and direction of companies." Through this bill the government aims to "create a climate of confidence for business activity in which genuine commercial endeavour will prosper and the prospects for economic development in general will be enhanced." The basic act remains the Companies Act 1963, which consolidated previous companies legislation. Ireland also incorporated the Fourth EEC Company Law Directive into their laws in 1986. Part V of the Act concerns Insider Dealing. Section 90 provides definitions which apply only to securities of public limited companies.

B. *Definition of Insiders*

Section 91 makes it unlawful for one connected with a company to deal in its securities "if he has any inside information related to it." Such persons are also prohibited from dealing in securities of any other company if they possess inside information related to their employment in the first company. In addition, one who receives inside information (a tippee) is precluded from dealing. The law likewise prohibits tipping on the basis of inside information.

C. *Punishment and Sanctions*

1. *Civil*

Section 92 provides civil punishments for insider trading. One who engages in insider dealing will be held liable to compensate any other party to the transaction who did not possess the relevant information. That person may be liable to account to the company that issued the securities for any profit on the transaction. Section 93 contains limited exceptions to the general rules.

2. Criminal

No criminal penalties are provided for violations of the statute.

D. Conclusion

In Ireland, recent proposals have been made to move the job of appointing inspectors from the Minister to the High Court and to authorize the Minister to obtain information directly from companies instead of having to conduct a formal investigation. Proposals have also been suggested that would require directors to disclose their financial interests in companies.

IV. FRANCE

A. Governing Statute

The French Government regulates insider trading through the Ordonnance of September 28, 1967, n° 67-833 of the Code on Corporations (*Code des Sociétés*), as amended through the present date. This ordonnance provides for the creation of the Commission des Opérations de Bourse (COB). It sets forth requirements for public disclosure of pertinent information regarding the status and activities of corporations, as well as prohibits certain types of insider trading. Article 10-1 (L. n° 83-1 of January 3, 1983) regulates insider trading, and article 10-2 (L. n° 85-1321 of December 14, 1985) provides for the application of the criminal punishments set forth under article 405 of the Penal Code to tippers and exploiters of privileged inside information.

Presently both the Sénat and the Assemblée Nationale have passed different bills which aim at reforming the stock exchange rules.³ These deal only indirectly with insider trading. A compromise bill will likely be proposed in the near future. These bills would add stiffer penalties to insider trading violations.⁴

B. Definition of Insiders

Article 162-1 of the law of 1966 and 1983 provides a definition of insiders to be regulated under the provisions (*les initiés de plein droit*.) Two categories of insiders are regulated by French laws: primary insiders who due to their high position in the corporate structure regularly have access to confidential information regarding the corporation; and secondary insiders who obtain information by means of their occupation.⁵ Those included in the first category are the chief

3. Sénat n° 130 (1987-1988); Assemblée Nationale N° 1002 (1987-1988).

4. See Coignard, La déontologie, une valeur en hausse à la Bourse de Paris, LA NATION, Apr. 30, 1987.

5. See Ducouloux-Favard, Delit d'Initié, 5 JURISCLASSEUR I (1987) (Fascicule 112-4-D).

executive officer, general directors, administrators, members of management, as well as permanent representatives of legal persons (such as partnerships or corporations). Immediate family members of directors and officers of a corporation are deemed "insiders" under French law.

With regard to these primary insiders there is a presumption that they knew the information was privileged and that they intended to wrongfully profit by it. This presumption is set forth by article 162-1 of the Code of Corporations. All those who have profited, directly or indirectly, by trading on the stock exchange are presumed to have done so through their position as an insider.

Those who obtain privileged information as a result of their profession or positions are also considered to be insiders subject to the regulations. Courts have given an extreme interpretation to this category. For example, liquidators and provisional administrators (trib.; gr. inst. Paris 30 mars 1979), employees of the corporation and its subsidiaries (trib.; gr. inst. Paris 18 avril 1979), stockbrokers or bank employees (trib. gr. inst. Bordeaux 25 mars 1981), journalists (trib. gr. inst. Paris 12 mai 1976), among many others have been held to be subject to the French insider trading restrictions.⁶

In addition to bankers and stockbrokers, all managing personnel of stock companies must abstain from trading their company's securities on the exchange as long as material information has not been publicly disclosed. This includes those who obtain privileged information through other legal means, even through an ordinary contract.⁷

Tippers are not directly regulated, but those who directly or indirectly propose that others trade on the exchange on the basis of privileged information will be held responsible for their recommendation. Tippers may be prosecuted under article 405 of the Penal Code.

The corporation will not be held liable for its transactions, but those who directed the transaction, or the directors of the corporation, will be held personally liable for the resulting damages.

C. Regulated Information

The old 1970 definition of privileged insider information under article 10-1 was limited to specific types of information. It stipulated that the information must be privileged, specific, and relate to technical, commercial, or financial aspects of the corporation's status or activity.⁸ Under present legislation, "privileged information" includes information of a sufficiently precise, particular, and certain character concerning the securities or business of a corporation which could

6. Ducouloux-Favard, *Les initiés: leurs obligations à l'égard du marché boursier*, LES PETITES AFFICHES, No. 112, Sept. 17, 1986, at 5, 7.

7. *La grande peur des initiés*, LE REVENU FRANÇAIS, July 1987, at 15.

8. Robert & Viandier, *La Surveillance des placements et des marchés* (L. n° 83-1, 3 Jan. 1983, art. 33 à 41), ETUDES ET COMMENTAIRES, at 74.

reasonably be expected to influence the value of the securities on an exchange.⁹ Thus, under the expanded definition, privileged information is no longer limited to technical, commercial, or financial aspects of the corporation's business.

D. Regulated Transactions

Transactions taking place privately, outside the stock exchange, are not protected by the legislation. Only those transactions which occur on a stock exchange are covered by the law.

The legislation imposes on insiders an obligation to abstain from directly or indirectly (through a third party) trading in securities of corporations about which they possess privileged information until that information is revealed to the public.

E. Punishment and Sanctions

1. Prevention

The COB was created by article 1 (L. n° 85-695 du 11 juill. 1985) of Ordinance n° 67-833 du 28 septembre 1967. The COB is empowered to monitor and investigate transactions occurring on the French stock exchanges, and to control the public disclosure of corporate information.

The COB possesses no explicit authority, however, to investigate transactions executed through foreign banks or finance companies located in other countries.¹⁰ Yet article 33 of Law 83-1 of 1983 permits the COB to exchange information with foreign authorities in a "spirit of international development and cooperation" in order to suppress transactions effected by means of foreign banks. Article 34 submits to the Commission's jurisdiction all securities issuers besides the state.¹¹

2. Civil

The only remedy available to private citizens injured by insider trading is the *action civile* which may be initiated in the criminal courts and would be considered at the same time as the public criminal action. Other civil actions must satisfy the Court of Cassation's requirements. The requirements are so strict that only one case has been successfully instituted.¹²

Administrators or executives of a corporation are personally liable to anyone

9. For comments on article 10-1 of the ordinance of Sept. 28, 1967, March 30, 1977 Paris, J. C. P. 1978.II.18789 obs. Tunc. see Memento Pratique Francis Lefebvre, SOCIÉTÉS COMMERCIALES, at 717-18 (1987-1988).

10. Commission des Opérations de Bourse, 9^{ème} Rapport au Président 1976, at 90.

11. Ducouloux-Favard, *supra* note 6, at 5.

12. Saint-Guilhem, 1976 J.C.P. II. No. 18496 (note A. Tunc.) (1st case) (Trib. gr. inst. Paris, May 12, 1976). See 10A INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION 7-41 (H. Bloomenthal ed. 1987).

who is able to demonstrate a loss resulting from the violation. This includes the corporation itself, the stockholders, and third parties. For statutory support, see articles 244, 245, and 249 of the 1966 Act which impose liability for all violations of the provisions applicable to stock companies.

Some out-of-court settlements have been reached by which insiders disgorge their profits and compensate the corporation or the stockholder who have been injured by the prohibited transaction.¹³

3. Criminal

The public prosecutor prosecutes all claims under these provisions. The Commission has increased its investigations from thirty-three in 1985 to sixty-nine in 1986.¹⁴

No fraudulent or speculative intent need exist in order for an insider to be held liable under the insider trading legislation. Conviction under these laws results in a period of imprisonment from two months to a maximum of two years. A fine may be substituted or added. Fees, under article 10-1 (L. n° 83-1 du 3 janv. 1983), will range from six thousand francs to a maximum fine of five million francs or four times the profit gained by the transaction, whichever is higher.

Currently, under French insider trading laws only individuals may be prosecuted. Thus, criminal sanctions fail to deter insider trading done on behalf of a corporate shareholder.¹⁵

V. WEST GERMANY

A. Governing Statute

Insider trading regulations in West Germany are part of a special commercial code encompassing those who engage in transactions on the exchange (*Kaufleute*). This code is part of federal law and serves as a special code for admission to the stock exchange. The insider regulations are not part of federal law, although they are incorporated in the code. These regulations are guidelines which operate only on the private contractual level between insiders and the corporations by which they are employed.

A committee of experts formulated the West German regulations in 1970. All parties which would be affected by the regulations participated in the drafting of these guidelines. These experts were for the most part members of a Working Committee of the German Stock Exchange and worked in cooperation with the "top union" of the German economy (*Spitzenverbände der deutschen*

13. Commission des Opérations de Bourse, 8^{ème} Rapport au Président 1975, at 97 *et seq.* See also 9^{ème} Rapport au Président 1976, *supra* note 10, at 91.

14. Commission des Opérations de Bourse, 19^{ème} Rapport au Président 1986, at 90.

15. Bloomenthal, *supra* note 12, at 7-37.

Wirtschaft)—made up of members of management from the major corporations. Representatives from the Ministry of State, of the stock exchange, and the banks also attended the formulation meetings.

The rules set forth apply only to limited liability corporations which have voluntarily subjected themselves to the regulations. Corporations are expected to incorporate the regulations into their management and employee structure. In business practice, the guidelines are usually a part of the employment contract.¹⁶ The complete text of the German insider guidelines including the official annotations can be found in Baumbach-Duden-Hopt, *Handelsgesetzbuch*, 27. Auflage, München 1987. This commentary on the German commercial law includes the so-called *Nebengesetze*, with the insider trading sections (16) *Insiderhandels-Richtlinien* and (17) *Händler- und Beraterregeln*.

B. DEFINITION OF INSIDERS

Insiders are legal representatives and members of boards of directors of corporations or adjoined corporations (such as subsidiaries or parent corporations). Under section 2 of the regulations insiders include directors, those in management and employees who have access to certain types of confidential information such as changes in earnings, expected dividend rates, merger offers, and takeover bids. There are no general criteria for employees who will be considered insiders. Every corporation is permitted to set its own specifications. The primary factor in determining insider status, however, is the proximity of the person to the sources of insider information.

In addition to corporate employees, German stockholders who own more than twenty-five percent of the shares of a corporation are viewed as having insider status. Directors and employees of banks and financial institutions are also considered insiders as far as they have access to inside information such as changes in dividend amounts, liquidation of stock, or other similar developments.

If an insider obtains information from a source not involving his or her employment or special access to confidential information, then that person is not forbidden to trade in those securities on the market. Likewise, tippees are not regulated by the guidelines.

C. Regulated Information

Inside information is defined under paragraph 3 of section 2 as knowledge which is not generally (publicly) known which may influence the course of trade of insider securities or "papers" (*Insiderpapiere*).

16. See (16) *Richtlinien für Insider-Geschäfte in börsennotierten oder öffentlich angebotenen Aktien* (Einleitung, ¶ 5, *Insiderhandels-Ri*), vom 1. Juli 1976, Baumbach/Duden/Hopt, *Handelsgesetzbuch*, 27. Aufl. (1987); see generally Pfister, *Stand der Insiderdiskussion*, *ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT* 381 (1981).

Insider securities are defined under *Insiderhandels-Ri 2*, paragraph 2, as corporate securities (*Aktien*), bonus or dividend shares or rights (*Genussrechte*), convertible debentures or bonds (*Wandelverschreibungen*), participating (income) debentures or reorganization bonds (*Gewinnschuldverschreibungen*), options (*Optionsscheine*) and subscription privileges (*Bezugsrechte*).

D. Regulated Transactions

The regulations apply only to trading which occurs on West German stock exchanges. Paragraph 2 of section 3 states that insiders are prohibited from using insider information in order to gain a profit for themselves or to give an advantage to third parties.

E. Punishment and Sanctions

1. Procedure

Inquiries are initiated by complaint. An inquiry board is selected by the listing committee of the corresponding stock exchange. The board consists of a judge and four members chosen from the industry sector. This inquiry board reports its unpublished findings to the corporation involved and to the Federal Minister of the National Economy.

A committee has been organized to investigate potential violations of insider trading guidelines. This committee possesses special investigatory powers which include the ability to force any insider under investigation to submit all information he has regarding transactions made by him during the stated time period. He must specify the names of banks who administered their insider securities during the stated time period. In signing the contract with the corporation which included insider trading guidelines, the insider impliedly authorized the banks dealing in that corporation's securities to divulge information which otherwise would be protected under secrecy laws. Should the insider refuse to permit the bank to disclose relevant information, the committee may sue the insider and force him to permit the disclosure.

The review panel determines whether the insider has violated the insider trading guidelines. It establishes the facts of the transaction as an assessor in the arbitration between the corporation and the insider. If the panel concludes that the insider breached the trading regulation, it informs the corporation or credit bank, and the appropriate ministry.¹⁷

2. Civil

Section 3 of paragraph 4 and section 5 set forth the repercussions of violations of the regulations. Since the regulations are adopted only by private contract

17. Hopt, *The German Insider Trading Guidelines—Spring Gun or Scarecrow*, 8 J. COMP. BUS. & CAP. MKT LAW 381, 383–384 (1986).

between the corporation and those designated as insiders, only a private contract right is involved. Under this right, insiders may be dismissed from their jobs or otherwise punished in relation to their employment situation. The major penalty is the requirement that the insider forfeit the profits made as a result of the forbidden transaction to the corporation with whom they have insider contact.

3. Criminal

The regulations provide no criminal penalties.

F. Conclusion

Should the EEC Proposed Directive on Insider Trading be accepted by the European Council, West Germany can be expected to implement legislation in conformity with it.

VI. SWITZERLAND

A. Governing Statute

Swiss law does not currently proscribe insider trading. New legislation will soon be voted on, however, which will impose criminal sanctions for insider trading violations. A bill was originally submitted to the Swiss Senate in the Autumn 1986 Session and remains in "revisited draft bill form." On October 7, 1987, the National Council approved a law providing for penal sanctions for insider trading on the Stock Exchange by a vote of 110 to 3. The House of Commons approved a text which adopts a more severe approach to insider trading than that adopted by the Council of States. The last version, adopted by the National Council, has proven to be a sort of compromise.¹⁸ The legislation is expected to take effect early in 1988. It will take the form of article 161 of the Penal Code, "Misuse of Confidential Information," and will contain four sections.

The Swiss Government has been attentive to problems of international securities regulation. On August 3, 1982, before the Swiss Government considered enacting insider trading prohibitions, it entered into a Memorandum of Understanding with the United States Government. This Memorandum established means by which the two governments could cooperate in the international law enforcement of insider trading. While Swiss bank secrecy laws are waived in

18. See also Studer, *Swiss Ban on Insider Trading Advances in Parliament Vote*, Wall St. J., Oct. 8, 1987, at 44, col. 4. For recent developments see generally Krauskopf, *Die Neue Insidernorm*, WIRTSCHAFT UND RECHT, Jg. 38, Heft 2 (1986).

Switzerland only in cases of Swiss legal violations, the government made a partial exception for the United States Government in the Memorandum and in a Private Agreement Among Members of the Swiss Bankers' Association. Section 1, paragraph 4 of the Memorandum states that:

The parties concluded that the conduct of persons who utilize Swiss banks to effect securities transactions in the United States, in order to take advantage of material non-public information, is detrimental to the interests of both nations.

The Memorandum and the Private Agreement expanded the degree of cooperation between the two governments with regard to criminal activities which had been provided for in the 1977 Treaty on Mutual Assistance in Criminal Matters. Where the original 1977 Treaty does not assist the United States with regard to insider trading allegations or where the United States is unable to obtain evidence through the compulsory process, under section 3, paragraph 1 of the Memorandum, the Agreement permits:

. . . participating banks to disclose the identity of a customer and certain other relevant information, under certain specified circumstances, in response to a request made by the Department of Justice and on behalf of the U.S. SEC and processed through the Federal Office for Police Matters. It would also contain certain safeguards regarding protection of customers and the sovereignty of Switzerland.

If the Swiss Government enacts insider trading legislation this special arrangement will no longer be necessary.

B. Definition of Insiders Under Proposed Legislation

Section 1 of the new legislation defines "insider" as one who serves as a member of a board of directors, as an officer or auditor (representative) of a corporation. Attornies and representative agents for private companies, or parents or subsidiaries of private companies, and those who serve in the capacity of a public official or their assistant are also included in the definition of insider.

Section 2 states that tippees and third parties will also be held legally responsible for trading, as described in Section 1, which occurs on the basis of inside information whether it was obtained directly or indirectly.

C. Regulated Information

Section 1 defines "confidential information" as information which, if disclosed, would foreseeably exercise a notable influence on the price of securities traded on the Stock Exchange or *avant bourse* (at the Stock Exchange by authorized brokers, but not during the opening hours of the market). These securities include shares, other securities or assimilated "non-securities" bills of the corporation (*effets comptables*), and option trading in those securities.

D. Regulated Transactions

All transactions by which an insider makes an improper profit on the basis of insider information will be prohibited. Section 2ter clarifies that the facts referred to in sections 1 and 2 shall include the imminent offering of new participating certificates, a merger or similar information of equal significance. Section 3 notes that sections 1 and 2 apply to both corporations involved in a merger consideration. Under section 4, sections 1 through 3 apply by analogy when the misused confidential information relates to stocks, other securities, "non-securities" bills or options of a cooperative company or a foreign company.

E. Punishment and Sanctions

1. Civil

No civil penalties are as yet envisioned.

2. Criminal

The new law calls for prison sentences as long as three years and fines of as much as forty thousand Swiss francs "for those who personally profit from or help others gain from confidential knowledge that could 'significantly'" influence the price of a stock or other financial instruments.¹⁹

Insiders who possess confidential information and obtain for themselves or a third party a pecuniary advantage by misusing that information, or communicate such information to a third party and, by this means, obtain a pecuniary advantage for themselves or for a third party, will be punished by imprisonment or a fine.

Section 2 states that the third party or tippee to whom such information is directly or indirectly communicated by a person referred to in section 1, who misuses this information and thereby obtains a pecuniary advantage for himself or a third party, will be punished by a one year maximum imprisonment or a fine.

Article 36 of the Swiss Penal Code stipulates that when no maximum penalty for imprisonment is specified, the offender may be sentenced to a prison term of up to three years. When no maximum fine is specified, the offender may be sentenced to a fine of up to 40,000 Swiss francs. The judge may extend the fine beyond the maximum provided for elsewhere if "cupidity" can be shown.

F. Conclusion

American pleas for mutual aid in preventing insider trading have influenced the Swiss decision to consider legislation making insider trading a criminal offense

19. *Id.* at 44, col. 4.

in Switzerland. Fears have been expressed that the Swiss Government will pass legislation only to please the United States and that the statute will only serve as decoration. One Swiss official was cited as stating: "It will have no effect at all on our trading. The law will legally establish what we already de facto do today."²⁰ The Swiss have not regarded insider trading as especially problematic. In the last twenty years, approximately ten cases of insider trading were investigated.²¹

VII. BELGIUM

A. Governing Statute

Belgian law currently contains no provision regulating insider trading. However, during the spring of 1987 the Belgian Government presented a bill to the Parliament which would modify article 107 of Book I, Title V of the Coordinated Statutes on Trade (*Code de Commerce*). The article provides a general framework to incorporate the European Directive of March 17, 1980 by requiring semestrial publication of a listed corporation's activities and finances. The Explanatory Memorandum written by the Government to explain its intentions to the Parliament states that this modification would provide for temporary suspension of trading on the market in those securities which are suspected of being subject to insider trading influence.²² If passed, the general laws would be expanded and set forth in a more detailed fashion by royal decree.

Another bill adds two new articles to the penal code: articles 27 and 28 (1986-1987, N.1). These would permit enforcement of the regulations of article 107 by adopting penal sanctions under article 27, modified by the law of June 30, 1975. This would also implement into Belgian law the three directives concerning securities adopted by the Council of the European Communities. These include the March 5, 1979 Directive on conditions for admission to an official listing; the March 17, 1980 Directive concerning the dispersal of information, the control of the contents of that information, and the circumstances under which such information must be disclosed; and the February 15, 1982 Directive concerning periodical information to be publicized by corporations listed on the stock exchange.

Although the Belgian Senate adopted the bill just before the 1987 summer recess, the House of Representatives has yet to adopt it. Due to the current political problems in forming a government after the December elections and the transitional government's lack of effective legislative power, the chances of the bill being adopted as law remain uncertain.

20. Bowers & Studer, *Stock Move?: Proposed Swiss Ban on Insider Trading May Have Little Effect*, Wall St. J., Aug. 5, 1985, at 24, col. 3.

21. *Das Interesse der Banken an der Lösung des Insiderproblems*, Neue Zürcher Zeitung, Feb. 4, 1986, at 19.

22. See *Projet de loi belge*, 533 (1986-1987) N. 1, at 48 (Explanatory Memorandum, Ch. IV).

B. Definition of Insiders Under Proposed Legislation

The proposed law considers all persons who obtain privileged information by virtue of their profession or functions to be insiders.²³ Responsibility for improper use of inside information would be imposed upon those independent of the corporation, but who obtain privileged information concerning other parties by means of their occupations. Among these are included civil servants, higher staff of administrations or firms (*les cadres*), notaries, lawyers, and judges.²⁴

C. Regulated Information

The proposed law defines privileged information as confidential information which, due to its sufficiently precise and certain character, would influence to a substantial degree the trading of those securities on the public exchange if it were rendered public.

D. Regulated Transactions

Insiders are prohibited from:

1. Directly or indirectly obtaining or disposing of securities by exploiting information about which they have knowledge in order to realize a profit or avoid a loss;
2. Advising third persons, on the basis of that information, to sell or buy such securities in order to allow them to gain a profit or avoid a loss;
3. Or communicating that information to third persons so they will be able to realize a profit or avoid a loss.

E. Punishment and Sanctions

1. Civil

The current proposed bill contains no civil remedies, although it might be possible to obtain damages in a negligence suit.²⁵

2. Criminal

Chapter four of article 27, section 1 provides for imprisonment from one month to one year and/or a fine of between fifty and one thousand francs. Additionally, if the operations alluded to above took place on the exchange, the offender may be forced to pay a sum corresponding to all or part of the profit acquired directly or indirectly or of the loss avoided. This sum can be recovered as a fine.

23. *Id.* Ch. IV, Art. 27, 533 (1986–1987) N. 1, at 68.

24. *Id.* at 533 (1986–1987) N. 2, at 36 (Report of Senator Cooreman, sec. 3.4).

25. Bloomenthal, *supra* note 12, at 8A–49.

Section 2 gives the Tribunal the authority, like that given the King's prosecutor, to ask the advice of the Banking Commission of the Exchange Commission concerned and/or of the particular Stock Commission in all cases of procedure. These entities shall offer their advice within one month of the request unless the Tribunal or King's Prosecutor extends the period. The investigatory procedure will continue in cases where an extension is given.

F. Conclusion

The Banking Commission has condemned insider trading in recent reports as being contrary to professional ethics. Although many rulings of the Banking Commission are often referred to as "soft law" because they lack enforcement capabilities, the business community highly regards the published opinions of the Commission. A new attitude toward securities regulation has motivated the Commission and the new legislative approach. It emphasizes the necessity for all investors to be placed on an equal footing and for the public to maintain confidence in the securities exchanges.²⁶

Recently, the Belgian Government decided not to adopt legislation which would force foreign traders on the Belgian stock exchange to disclose their identity. The Council of Europe and the European Commission are presently looking into this issue. For now the Belgian Government will await a unified plan to be formulated by the European Community before acting on this issue.

VIII. LUXEMBOURG ²⁷

The Luxembourg Government has passed no legislation prohibiting insider trading. While it has been suggested that the laws against embezzlement could apply to some severe instances of this activity, there have been no such prosecutions. Instead, Stock Exchange rules regulate trading. Member firms are prevented from executing transaction orders for employees of other firms. The Stock Exchange Commission may temporarily suspend trading in the securities of a corporation if it believes that "irregularities" are occurring. Corporations may be required to open their books for inspection by the Commission. In some instances, the Commission has gone as far as requiring the timely publication of "material price sensitive information."

In addition, Luxembourg has published the European Code of Conduct in its *official Gazette*. The Code specifically condemns insider trading.²⁸ This Code has been endorsed by the Monetary Institute (*Institut Monétaire*) and the Stock Exchange. No specific cases of insider trading violations have been reported.

26. *Projet de loi belge*, 533 (1986-1987) N. 2, at 35 (Report of Senator Cooreman, section 3.4).

27. See generally, Bloomenthal, *supra* note 12, at 8B-46.

28. See European Commission Recommendation of July 25, 1977, 20 O. J. Eur. Comm. (No. L. 212/37) (1977).

IX. THE NETHERLANDS

A. *The Governing Statute*

No specific statutory provisions exist in the Netherlands to prohibit or regulate insider trading. However, the Government does have disclosure requirements which are partially aimed at controlling and minimizing insider trading relating to take-over bids.²⁹

In April of 1987 the Committee on Corporation Law, which advises the Minister of Justice, drafted article 336a, S. 19935 (1986-1987) to regulate insider trading under the Penal Code. The new Dutch legislation has not yet been voted on in parliament. The results of the forthcoming vote may be expected in the latter half of this year.

B. *Definition of Insiders*

Section 1 defines insiders as those who possess privileged information (*voorwetenschap* or *vorwissenschaft*), as defined under the statute, which has not been publicly disclosed. Those insiders who use such information to their advantage in the Netherlands by acquiring or disposing of securities registered on the Stock Exchange will violate the article.

C. *Regulated Information*

Under section 2, insider knowledge is defined as knowledge concerning a special characteristic of the legal entity or corporation to whom the securities relate or concerning the trade in those securities:

1. of which the one who is familiar, knows or reasonably should know that they are not public and that they could not have come outside of a circle of persons with a duty of confidentiality without violation of a secret; and
2. the publication of which will affect, as one reasonably could expect, the price fluctuation of the securities.

Section 3 specifies that an individual will not be punished if, only having this prior knowledge (*voorwetenschap*) with respect to the trade, he acts in conformity with the rules of good faith in order to execute an assignment on behalf of another (in the service of those who requested this transaction).

D. *Punishment and Sanctions*

1. *Civil*

No civil penalties are specified.

29. Bloomenthal, *supra* note 12, at 8-27.

2. Criminal

The Stock Exchange is monitored and “overseen” by the state and, under section 1, violators will be punished with imprisonment for a maximum of two years and/or a fine of the fifth category.

X. SWEDEN

A. Governing Statute

The Securities Market Act, SFS 1985:571, entered into force on October 1, 1985. The version of the Act used in this survey includes the amendments to the Act entering into force on September 1, 1986, SFS 1986:313.

Sections 1 through 3 set forth general goals which include the maintenance of public confidence in the securities market and the reform of the securities laws to ensure that individuals’ capital investments are not improperly jeopardized.³⁰

B. Definition of Insiders

Sections 5 and 6 identify the “persons” to be covered under the Act to include corporations, subsidiaries of corporations, and individuals. Regulated “natural persons” include directors, managing directors of parent and subsidiary corporations, leading officers, auditors, and partners in corporate partnerships (excluding limited partners). It also includes other leading officers or holders of a “highly qualified assignment of a permanent nature for the company or its parent enterprise, if the position or assignment may normally be assumed to involve access to confidential information about circumstances which may affect the price of shares in the company.” Finally, those owning at least five percent of the share capital or number of votes attaching to all the shares in the corporation are also included in this definition.

C. Regulated Information

Section 8 of the Act defines confidential information as information which has not been publicly disclosed, and which, if generally known, would be likely to affect substantially the price of the company’s shares.

D. Regulated Transactions

1. General Provisions

Sections 7 through 16 deal exclusively with the methods used to prevent the use of confidential company information. Section 7 concerns public offers of

30. Securities Market Act, SFS 1985:571, ISBN 91-7176-107-1, (M. Naylor trans. 1986), at 3.

acquisition. All who learn confidential information in their capacity as employees or holders of assignments are prohibited from (on their own or another's account) purchasing or selling shares of the corporation. They may not advise others to do so before the offer has been made public or the offer lapsed. This also applies to other natural persons who hold at least five percent of the shares or capital in the corporation or have equivalent voting strength.

Section 8 deals with more generalized circumstances. One with an insider position in a company (not exclusive to the list in section 7) may not buy or sell any of the company's stocks or advise others to do so when:

- a. he knows of information relating to the parent enterprise which is not yet publicly known, "if those circumstances are likely to substantially affect the price of the company's shares when they become generally known;" and
- b. "when in other cases he knows of circumstances not made public concerning the activities of the company or its parent enterprise, if those circumstances are manifestly likely to substantially affect the price of the company's shares when they become generally known."

It is significant that no person will be held liable under this section unless he has been informed of his insider position as explained in sections 15 and 16.

2. Exemptions

Section 9 provides for exceptions to the prohibitions of sections 7 and 8. Those holding positions with stockbrokers are excluded from the regulations with regard to the buying or selling "on the stockbroker's account of shares in an OTC company to which the stockbroker is in a contractual relationship" referred to in section 4. An OTC company is a "Swedish company limited by shares which has concluded a contract with a stockbroker under which the latter will on request quote prices for shares in the company and buy and sell shares in the company at these prices." This position includes buying and selling of shares and share options. Those who hold a position with a stockbroker are allowed to execute orders to purchase or sell as part of their business in other instances. Another exemption includes purchases of "securities other than share options when the circumstances are likely to lower the price or sales of securities other than share options when the circumstances are likely to raise the price." Sales of shares belonging to natural or juridic (corporate) bankrupt persons are likewise excluded. Holders of share options may purchase shares to which the options relate or may sell the options on the day when the options expire. Issuers of share options may also buy and sell shares to which option relates when the options are exercised.

3. Notification Requirements

Section 10 provides for written notification to the Securities Register Centre by those with insider positions of all holdings of shares in the corporation, as well as any changes in their holdings. Section 11 states that notification shall be required from those closely related or closely associated to inside persons. These persons

include spouses, minors in the person's care, juristic persons over which the insider exercises "substantial influence" and shares a "substantial common economic interest based on a share in ownership or a comparable economic interest."

Notification is not required in several circumstances:

- a. when the person has not been informed of his insider position as under Sections 15 or 16;
- b. if the holding is less than fifty shares or if it has a market value of less than ten thousand kronor;
- c. if the change in holding after the most recent notification is less than fifty shares or has market value less than ten thousand kronor;
- d. if the holding increase is caused by a bonus issue or stock split;
- e. if it is limited to a "provisional share certificate received in exchange for another security" which includes rights letters, fractional certificates, provisional share certificates, option warrants, convertible instruments of debt, instruments of debt carrying an option to subscribe to new shares, and participating bonds (covered in section 4).

Section 12 specifies which informational details must be included in a notification statement. Section 13 designates time frames during which notification must be made. Section 14 relates to the duty of the Securities Register Centre to send out the information supplied to the Bank Inspection Board and the duty of the Company to retain a copy of the information to be available to all who wish to inspect it.

Sections 15 and 16 call for corporations to list all persons who will be considered insiders included in section 6. Section 15 demands that the company list all employees of and holders of assignments for the company and that it keep the list for inspection by any person. The company must inform all persons listed of their insider position and the notification requirements set forth by this statute. Section 16 covers those of parent enterprises whose duties parallel those set forth in section 15.

E. Punishment and Sanctions

1. Bank Inspection Board

Under section 3, the Bank Inspection Board will supervise compliance with the provisions of the Act. Sections 17 through 27 govern the operations of the Bank Inspection Board.

2. Civil

In addition to criminal penalties, which serve as the primary means of deterrence, section 31 stipulates that gains from an offense (covered by section 28) will be declared forfeit as long as it is not unreasonable to do so. Section 32 gives the right of public prosecution to citizens only by the consent of the Bank Inspection Board.

3. Criminal

Section 28 deals with penal sanctions for violators of the requirements set forth under sections 7 and 8. Penalties range from fines to imprisonment. No penalty will be assessed if the case does not affect public confidence in the securities market or if the violation is trivial for other reasons. No penalty is imposed in the “case of instigation or of complicity in an offense referred to in this section.

Section 29 states that those who wilfully or negligently fail to submit notification under section 10 within the stipulated time, will be subjected to a maximum six month imprisonment or a fine. The same penalty will be imposed if one provides incorrect or misleading information in the notification or fails to observe the requirement in section 14 that he keep a copy of the notification accessible to any person wishing to inspect it. Penalties will be imposed here, as above, only in non-trivial cases.

XI. AUSTRALIA ³¹

A. Governing Statute

The Australian government has legislated detailed insider trading regulations. Applicable statutes are contained in Part X of the National Securities Industry Code, and are supplemented by provisions in the National Companies Code and the National Companies and Securities Act.

B. Definition of Insiders

Section 128(1) of the National Securities Industry Code prohibits trading in securities of a corporation if one is “connected with the corporation and, by virtue of that connection, is in possession of materially price sensitive information that is not generally available.”

1. Natural Persons

Those connected with the corporation at any time in a six month period before a contemplated transaction are subject to a prohibition of trading in that company's securities. Section 128 appears to apply only to natural persons and not to corporations.

Under section 128(8) one is “connected with a corporation” if he:

- a. is an officer of that corporation or of a related corporation;
- b. is a substantial shareholder under the National Companies Code (has an interest, beneficial or otherwise, in ten percent or more of the voting shares of a listed public corporation); or

31. See generally, Bloomenthal, *supra* note 12, at 10–50 to 10–59; see also Herne, *Inside Information: Definitions in Australia, Canada, the U.K. and the U.S.*, 8 J. COMP. BUS. & CAP. MKT LAW 1–19 (1986).

- c. occupies a position that can reasonably be expected to give him access to price sensitive information, by virtue either of any professional or business relationship between himself and the corporation, or of his being an officer of another corporation of which is a substantial shareholder.

This language implies that outside consultants such as lawyers, accountants, and underwriters could be connected with a corporation so as to incur liability for insider trading. Under section 128(9), however, licensed dealers possessing price sensitive information may buy or sell securities as an agent for a client as long as he acts on specific instructions from the client and has not given any advice to the client concerning trading in those securities.

2. Corporations as Insiders

Although corporations are not considered capable of being “connected with another corporation” under section 128, corporations are prohibited from trading in securities of another corporation whenever any of the corporation’s officers are prohibited from dealing in them. Certain exceptions to this rule are available:

- a. if a decision to make transaction in the corporation’s name is made by someone other than a director or officer, and that person does not know of the price sensitive information; and
- b. if a valid “Chinese Wall” is erected by which the corporation ensures that confidential information will not be communicated to those trading in securities, and by which no insider with the price sensitive information gives trading advice to that person.

3. Tippees

Section 128(3) applies to “tippees.” A tippee with price sensitive information may not deal in the securities of a company if:

- a. he “has obtained that information, directly or indirectly, from a person whom he knows or ought reasonably to have known is precluded from dealing in those securities under Sections 128(1) and 128(2)”;
- b. the tippee associated himself with the insider when the transaction was made, or made arrangements to communicate confidential information.

C. Regulated Information

Insider information includes materially price sensitive information that is not generally available. More specifically, section 48(1) of the National Companies and Securities Commission Act prohibits any person administering cooperative scheme legislation from dealing in securities while in possession of price sensitive information acquired by reason of their connection with the administration of the scheme.

D. Regulated Transactions

Section 128(2) forbids trading in another corporation's securities if the confidential information relates to any actual or expected transaction involving that corporation and the corporation with which the insider is connected. That section targets insider trading which occurs prior to the announcement of a take-over or tender offer.

People who are precluded from dealing under sections 128(1) (2) or (3) are prohibited from soliciting any other person to deal in those securities. Section 128(5) states that such persons must not communicate price sensitive information to any other person if the securities are listed on a stock exchange and they know or ought reasonably to know that the tippee will directly or indirectly use that information to deal in those securities.

Section 229(3) of the National Companies Code prohibits officers or employees of corporations from improperly using information acquired by virtue of their position to gain, directly or indirectly, an advantage for themselves or any other person, or to injure the corporation. The term "officer" includes receivers and liquidators as well as directors, secretaries, and executive officers of the corporation. "Improper use" of information is not "authoritatively" defined. If one is considered to be in breach of a legal duty, one's actions will be held to be improper, although no provision in this Code specifically prohibits insider trading. The National Securities Industry Code, however, indicates that insider trading is an offense—so presumably insider trading would also be held to be "improper" for the purposes of section 229(3) of the National Companies Code.

E. Punishment and Sanctions

1. Civil

Section 130(1) of the National Securities Industry Code provides civil remedies against persons or companies which commit any offense under section 128, excluding those in section 128(5). Regulations impose a duty to compensate on individuals who violate sections 128(1), 128(2), 128(3), or 128(4) and on corporations which violate section 128(6). Violators will be held liable to reimburse any other party to the transaction who did not possess the price sensitive information for any loss incurred as a result. The difference between the price paid and that price at which the securities would be likely to have been traded had the information been generally known at the time serves as the measure of damages. Offenders must also return any profit made from dealing in those securities to the corporation which issued the securities involved.

The National Companies and Securities Commission can bring an action on behalf of a person or corporation to recover loss or profit from the insider if the Commission believes it to be in the public interest to do so. A violation under

section 48 will result in liability to compensate the other party to the transaction for any loss caused by the deal. A two year statute of limitations applies to a civil action under section 48 and under section 128.

Section 130(3) places a ceiling on the amount of compensation for which an insider or tippee will be held responsible. The maximum amount owed will be limited to the loss sustained by the other party to the transaction or the profit owed the corporation. Alternatively the court can subtract from the profit or loss the total of the amount that a court found the person to be liable to pay to any other person under either Part X of the National Securities Industry Code or section 229 of the National Companies Code by reason of the same act of transaction.

2. Criminal

Section 126 of the National Securities Industry Code sets forth criminal penalties. If a corporation is involved, it will be subjected to a fine not exceeding fifty thousand dollars. In cases of violations involving natural persons, a fine not exceeding twenty thousand dollars and/or imprisonment for a period of up to five years will be imposed. Section 128(10) allows for a defense that the other party to the particular transaction knew, or ought reasonably to have known, of the price sensitive information before entering into the transaction.

Section 48(1) of the National Companies and Securities Commission Act outlines penalties for insider trading by persons administering the cooperative scheme legislation. These include a twenty thousand dollar fine or up to five years imprisonment. The defense available under section 128 is unavailable under section 48.

The National Companies Code section 229(4) provides for punishments similar to those in section 48 of the National Companies and Securities Commission Act. An officer or employee violating section 229(3) will be subjected to a twenty thousand dollar fine, a maximum five years imprisonment, or both. Insiders will also be forced to disgorge any profits made or to compensate the corporation for any damages suffered as result of breach. A court which convicts under section 229(3) may award damages. Civil actions by the corporation are to be recovered in a separate action instituted by the corporation.

XII. CANADA ³²

A. Governing Statute

Seven of ten Canadian provinces regulate insider trading in conjunction with the Canada Business Corporation Act sections 121 through 125 under which

32. See generally UNITED STATES SECURITIES AND EXCHANGE COMMISSION REPORT TO THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS AND THE HOUSE COMMITTEE ON ENERGY AND COMMERCE ON THE INTERNATIONALIZATION OF THE SECURITIES MARKETS (1987) at III-139 to III-158; 10 INTERNATIONAL CAPITAL MARKETS AND SECURITIES, 1-94 to 1-96, 4-54 to 4-56, 4-77 to 4-81 (H. Bloomenthal ed. 1987); see also Herne, *supra* note 31.

federal corporations may be incorporated. Since the provinces have their own stock exchanges, the different provinces' legislation schemes apply to different securities and varied transactions. Considerable overlap in insider trading regulation results and the same corporation may be subject to sanctions under several different provinces.

Ontario represents one of the principal capital markets in Canada. This province maintains statutes which extensively regulate insider trading in the Ontario Securities Act (OSA).

B. Definition of Insiders

Ontario legislation defines insiders as those who stand in a "special relationship" with a reporting issuer. Those "in a special relationship" to the reporting issuer are defined under OSA section 131(7) as those who are:

1. insiders or affiliates of the reporting issuer;
2. directors, officers, or employees of the reporting issuer or of a company that is an insider or affiliate of the reporting issuer;
3. persons or corporations who, by virtue of their past, current, or proposed business or professional activities with or on behalf of the reporting issuer, have acquired knowledge of the material fact or material change; and
4. associates of the reporting issuer or of any of those just listed.

C. Regulated Information

The Ontario statute regulates information which concerns the selling of securities in a corporation with the knowledge of a material fact or material change with respect to the reporting issuer that has not generally been disclosed.

OSA section 1(1)22 defines a "material fact" as one which "significantly affects, or would reasonably be expected to have a significant effect, on the market price or value" of the securities.

OSA section 1(1)21 specifies that "material change" is "one in business, operations, or capital of the reporting issuer that would reasonably be expected to have a significant effect on market price or value of the securities, and includes a decision to implement such a change by the board of directors or by senior management who believe that confirmation of the decision by the board of directors is probable."

D. Regulated Transactions

Liability attaches under OSA section 131(1) in two main instances:

1. when insiders buy or sell based on confidential information; and
2. if insiders directly or indirectly communicate knowledge of a material fact or material change to a person who or company which thereafter sells securities of the reporting issuer.

E. Punishment and Sanctions

Three different means of enforcement are available to provincial administrators: administrative and civil sanctions, violations of provincial securities legislation, and breaches of the federal Criminal Code.

1. Administrative Sanctions

Provincial authorities may revoke licenses or registration of those registered on the securities exchanges after a hearing. Other tactics taken include the denial of exemptions for detailed registration and prospectus and take-over bid requirements. Under OSA section 69(1) the Commission may suspend trading in a corporation's securities if circumstances are discovered after acceptance of the prospectus which would justify its refusal. This would embrace situations where misleading or false information was contained in the prospectus or where material information was unjustifiably withheld from public knowledge. Although it is an unusual remedy, the Commission may apply to a court for an order commanding compliance with the sections under the Ontario Securities Act.

2. Civil

Persons who communicate inside information to third parties who in turn trade in those securities are liable to compensate the purchaser or seller of those securities for the loss incurred. Damages must be paid under OSA section 131(2) for those who themselves trade on inside information.

Defenses are allowed under OSA section 131(1)(a), (b), (c) and 131(2)(a), (b), (c). One will not be held liable for a transaction based on inside information if one had reasonable grounds to believe that the other party to the transaction knew the information. An insider may also avoid liability by proving that he did not use the confidential information in effecting the transaction or in communicating knowledge of the information to others who purchased or sold the securities in question.

If more than one defendant is involved, the liability will be joint and several under OSA section 131(5). OSA section 131(6) provides that the statutory measure of damages is the difference between the price paid or received in the transaction and the average market price of the security in the twenty trading days following general disclosure of the material fact or material change. The provision also allows for a court to consider other measures of damages as may be relevant in the particular circumstances. Under OSA section 131(4) defendants who are insiders, associates, or affiliates of the reporting issuer will be held accountable to the reporting issuer for any benefit or advantage received or receivable as a result of the purchase or sale of the securities, or communication of the material fact or material change, as the case may be. The defenses specified above apply to violations under this section.

OSA section 132 permits security holders, the reporting issuer, or the Commission to apply to the courts for an order requiring the Commission or authorizing

the security holders to commence or continue an action in the name of the reporting issuer to enforce the insider trading liability. OSA section 135 stipulates that an action to enforce liability provisions must be commenced within the earlier of 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action or three years after the date of the transaction.

OSA section 112 permits shareholders to request the courts to commence an action under the insider trading regulations. Companies' legislation schemes often make provision for derivative actions to be undertaken on behalf of the corporation and its shareholders. This is provided for under the Ontario Business Corporation Act section 97 and the Canada Business Corporation Act, section 232.

3. Criminal

Federal criminal sanctions relate to general offenses such as fraud and false pretenses. The Code specifically prohibits offenses relating to securities only in a few instances. Two examples include: knowingly making or publishing a false prospectus and fraudulently manipulating a stock exchange transaction.

XIII. JAPAN ³³

A. Governing Statute

Japan regulates insider trading through the Securities Exchange Law of 1948, as amended in June of 1985 (SEL). The Ministerial Ordinance Concerning Rules, etc. of Soundness of Securities Companies recently modified this law.³⁴

The government will soon enact new legislation, which will emphasize the enforcement of insider trading violations. A special task force of the Securities and Exchange Council of the finance Ministry issued a report in February of 1988 which recommends clearer definitions of "insiders" and "inside information," as well as stiffer civil and criminal sanctions for violations.³⁵

B. Definition of Insiders

Members of the securities industry, such as brokers and underwriters, are considered "insiders" within the meaning of the applicable statutes. Officers and employees of corporations are considered to be insiders as well. According to

33. See generally Kanzaki, *Developments in Insider Trading in Japan*, 4 J. COMP. CORP. L. & SEC. REG. 391-394 (1982); Bloomenthal, *supra* note 12, at 11-42 to 11-43; Ministry of Finance Ordinance No. 60, Nov. 5, 1965 (as amended Sept. 20, 1985).

34. Ministry of Finance Ordinance No. 60, Nov. 5, 1965 (as amended Sept. 20, 1985).

35. Graven, *Japan's Efforts to Fight Insider Trading Must Overcome Acceptance of Practice*, Wall St. J., Feb. 24, 1988, at 26, col 3.

1971 guidelines provided to the Securities Dealers Association by the Securities Bureau of the Ministry of Finance, corporate insiders include directors, key employees, or major shareholders of an issuing company.

The 1988 report proposes that investors be divided into three categories relating to their degree of access to information:

1. "insiders" including company employees and substantial shareholders;
2. "semi-insiders" such as stockbrokers, accountants, lawyers, government officials and other employees who, by contract, have access to inside information; and
3. "general recipients" which include journalists or spouses and relatives of other insiders.³⁶

C. Regulated Information

Those employed in the securities industry are specifically prohibited from trading securities on non-public, material information by the SEL and the rules of the self-regulatory body. Officers and employees of a corporation are prohibited by the SEL and the rules of the Ministry of Finance from trading for their personal benefit on "special information—such as purchase or sale orders from customers—obtained by virtue of their position."

The 1988 report of the special task force defines inside information as "any unannounced information that may affect share price movements." Examples of inside information as defined in the report include information concerning mergers, new stock offerings, new product and technology developments.³⁷

D. Regulated Transactions

Japan's regulations are modeled after United States legislation.

Article 50 covers generally prohibited activities. It applies to officers and employees and prohibits them from:

1. soliciting buying, selling, or other transactions of securities through offered opinions containing predictions concerning price fluctuations;
2. soliciting buying, selling, or other transactions of securities by undertaking a customer to absorb the loss incurred as a result of a transaction involving such securities;
3. undertaking any of the activities outlined in the Ministerial Ordinance Concerning Rules, etc. of Soundness of Securities Companies.

These include:

- a. making misrepresentations or misleading misrepresentations of a material fact with respect to a sale or purchase or other transaction in securities;
- b. soliciting customers to buy or sell securities by offering special benefits;
- c. series of acts of buying or selling with the intent to create a false market, or acts to entrust such actions to others knowing that a false market will result;

36. *Id.* at 26, col. 3.

37. *Id.* at 26, col. 3.

- d. deceptive dealing on margins accounts; e. buying and selling securities by an officer or employee of a company based on information obtained in the performance of his duties for the sole purpose of pursuing "speculative interests."

Japanese law contains an anti-fraud provision, SEL Art. 58, modeled on the United States Rule 10b-5. It prohibits the use of fraudulent devices with respect to buying, selling, or other securities transactions; the obtaining of money or property by using documents or representations containing untrue statements of a material fact or an omission to state a material fact necessary to make the statements not misleading; and the use of false quotations for purpose of soliciting buying, selling or other transactions of securities.

SEL article 189, paragraph 1, serves as a 16(b) type of provision which requires corporate insiders to disgorge short-swing profits. Unfortunately it has failed to operate effectively since the repeal in 1953 of their version of the American 16(a) provision. This article, like the United States counterpart, applies to officers or shareholders who own more than ten percent of the corporation's total number of issued shares.

E. Punishment and Sanctions

1. Preventative Measures

The administrative agency and self-regulating bodies try to educate businessmen about insider trading and prevent them from engaging in such activities. These bodies have provided guidelines by which securities companies investigate purchase and sale orders from corporate insiders before they are executed. Companies should refuse to close suspicious transactions and report any indications of insider trading to the stock exchange.

Examiners from the Ministry of Finance or the stock exchanges annually appraise compliance with the guidelines. Warnings are issued for those who fail to fulfill duties imposed by the law. The market surveillance department of each stock exchange monitors transactions on the exchanges and investigates unusual market action. Once the stock exchange receives reports of insider trading, it may prevent such transactions by temporarily suspending trade in a particular issue of securities. Although the suspension mechanism has been employed quite often,³⁸ the Japanese generally do not enforce most of the insider trading legislation, and rely for the most part on moral and social sanctions to prevent such activities.

2. Civil

In order for a victim to recover for a violation under the general anti-fraud provision, he must resort to article 709 of the Civil Code, the general tort

38. The Tokyo Stock Exchange suspended trading in particular securities issues twenty-four times in 1979, fourteen times in 1980, and sixteen times in 1981. Kanzaki, *supra* note 33, at 393.

provision, to recover damages. As of 1982, no court decisions had appeared under the statute for a ten year period.

3. Criminal

The Japanese government plans to legislate penal sanctions on insider trading. The special task force of the SEC of the Finance Ministry proposed that criminal sanctions be adopted in forthcoming legislation.³⁹

F. Conclusion

International pressures from the major economic powers have forced Japan either to conform its securities regulation to that employed in other countries or risk losing a major portion of its foreign market as a result of decreased confidence in the Tokyo Stock Exchange. The Government will either amend the Securities Exchange Law of 1948 or will promulgate a special statute. There is a good chance that the bill will be presented to the Diet this coming year. With new legislation on the drafting table, it is likely that Japan will begin to enforce sanctions against insider trading.

XIV. HONG KONG ⁴⁰

A. Governing Statute

Recent problems with the stability of the stock exchange has prompted the Government of Hong Kong to consider new legislation concerning insider trading. Stricter regulation of insider trading could be expected in the next year. Although the laws are likely change in the near future, the information provided in this section offers an indication of the lenient attitudes prevalent in Hong Kong with regard to insider trading.

No formal statutory controls existed in Hong Kong until 1978. In that year the Government reacted to a major "scandal involving two directors of a company, the "Wheelock Marden Affair", by amending the defunct Securities (Amendment) Ordinance of 1978 and created Part XIA of the Ordinance on Insider Dealing. They rejected solutions involving criminal or civil penalties and employed means by which insider trading would "attract the risk of public exposure" through a committee known as the "Insider Dealing Tribunal."

B. Definition of Insiders

Section 141E regulates those connected with a corporation. Those "connected" include directors, officers, employees or "substantial shareholders" of the corpo-

39. Graven, *supra* note 35, at 26, col. 3.

40. *See generally*, Bloomenthal, *supra* note 12, at 12-120 to 12-128.

ration whose securities are involved. "Connected individuals" include those who, by means of their business or professional position, may reasonably be expected to have access to relevant information regarding a corporation's securities are also prohibited from dealing in those securities. This includes employees of subsidiary and parent corporations, as well as those privy to information concerning tender-offers and take-overs. One will also be considered to be "connected" with a corporation if one has had dealings with a corporation in any of the above manners in the six months prior to the transaction in question. "Substantial shareholders" include holders of equity share capital of a nominal value exceeding ten percent of that share capital or holders of over ten percent of the voting power at any general meeting.

C. Regulated Information

Under section 141D(1-2), "relevant information" must concern securities and must be information which "is not generally available but, if it were, would be likely to cause a material price change in those securities."

D. Regulated Transactions

Under section 141 B, insider trading in a corporation's securities will be considered "culpable" when the transaction is "made, procured or 'occasioned'" by one connected with that corporation who possesses "relevant information" with regard to those securities. One who "tips" or discloses relevant information concerning those securities to a third party or "tippee" will also be held responsible if the tipper "knows or has reasonable grounds for believing that the tippee will use that information to deal, or procure another to deal, in those securities." The tippee must actually use the information as a basis for an ensuing transaction in order for the tipper to be considered culpable.

Section 141 of the Ordinance specifies that some types of insider trading are not "culpable." Those securities which are not listed on an approved stock exchange will not be subjected to the requirements under the regulation. Bona fide transactions executing underwriting agreements or obligations of personal representativeness, liquidators, receivers, or trustees in bankruptcy are also excluded. Certain considerations exclude individuals from culpability even though sanctions would otherwise apply. If a "Chinese Wall" effectively insulates those with relevant knowledge from those who execute transactions in the securities, then the individual who traded on good faith will not fall under the regulation. One will not be held accountable for trading if one's purpose for trading was not to earn a profit or avoid a loss by using the relevant information. Finally, one who merely executes a transaction on an order from another, without having advised that person or communicated any relevant information to him, will not be sanctioned by the Tribunal.

E. Punishments and Sanctions

The Insider Dealing Tribunal decides whether or not to hold an individual culpable. Section 141G and paragraphs 2-11 of the Third Schedule set forth the Tribunal's structure and membership. Formal inquiries are initiated under section 141H(1-2) by the Financial Secretary, either on his own initiative or on recommendation by another (including private individuals). Once investigation has begun, the Tribunal conducts an inquiry under section 141I(1) and prepares a written report. The Tribunal may subpoena and examine witnesses and documents and issue arrest warrants for those who fail to comply with its orders, and may also issue warrants for search and seizure of pertinent material. The Tribunal retains extensive powers under both the Commissions of Inquiry Ordinance and the Securities Ordinance. The Commissioner also possesses broad powers to review corporations' books and records. Those who fail to cooperate with his orders may be liable on conviction to a five thousand dollar fine and three months' imprisonment. The same punishments apply to other offenses, such as providing misleading or false information. Privilege does not excuse anyone from cooperating with the Commissioner. Except for disclosing clients' names and addresses, legal advisers are not required to disclose verbal or written privileged communications made to or by them. After inquiries and conclusions are made, the Tribunal publishes a report, either finding culpability or innocence. "Ideally, those charged with insider dealing would have been either publicly exonerated, or found culpable, in which case they would have suffered the indignity of public exposure of their conduct."⁴¹

F. Conclusion

Only one case, the Hutchison Whampoa Limited Case, had been conducted as of 1985 under the Insider Dealing provisions. The Tribunal published the report finding culpability in that case nearly two and one-half years after the "culpable" trading occurred. This inquiry led to criticism of the process and suggested amendments, some of which may soon be enacted into law. One of the reforms suggested is a more specific definition of "culpable insider dealing": "The conscious use for the purpose of profit or of avoidance of loss of confidential price-sensitive information to buy or sell shares to which that information relates or the disclosure of confidential price-sensitive information to a person likely to use the information for that purpose."⁴² Reforms were also suggested which would eliminate many of the formal procedural requirements, in order that the report may be published in a more timely fashion for greater impact.

41. *Id.* at 12-128.

42. *Id.* at 12-131.