REGULATIONS TO CURB INSIDER TRADING IN PAKISTAN: A COMPARATIVE ANALYSIS WITH OTHER LEGAL REGIMES

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FINAL APPROVAL

It is certified that we have read the dissertation submitted by Mr. Najeeb ullah Khan, Registration No. 94-FSL/PHDLAW/F-16 on "***Regulations to Curb Insider Trading in Pakistan: A Comparative Analysis with other Legal Regime***" in Department of Law, Faculty of Shariah & Law. We have evaluated the dissertation, and found it upto the requirements in its scope, and quality by the International Islamic University, Islamabad, for the award of PhD Law Degree.

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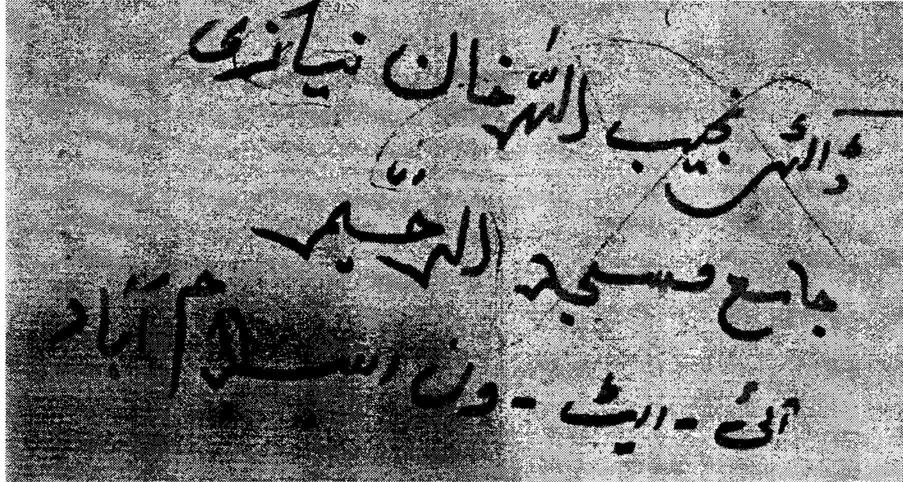
Dedication

I dedicate this thesis to one & only **Qari Abdul Jabbar**, Jamiah Masjid Al-Raheem, I-8/1, Islamabad. He jot down my name at the last page of The Holy Quran as "Dr. Najeeb ullah Khan Niazi" when I completed reading it for the 1st time and at that time I was in Class four of school, i.e., 1995. Seemingly, everyone thought that I would become MBBS doctor and for that purpose I had also put in my all efforts, however, Allah Almighty has destined me to become a PhD Doctor. It was not even in my dreams/thoughts, undoubtedly, man proposes and God disposes.

"Verily, Allah is the best Planner" (Al-Quran)



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Declaration

I, Najeeb ullah Khan, hereby declare that this dissertation is original and has never been presented in any other institution. I, moreover, declare that any secondary information used in this dissertation has been duly acknowledged.

Student:

Signature: ______________________

Abstract

The term "insider" was first used in US legislation, and other nations such as the UK and Europe continued and implemented similar legislation to prevent insider trading. Insider trading laws have been unclear, confusing, and out of step with the times for far too long. The law has evolved via a succession of fact-specific court rulings applying the general anti-fraud sections of our securities laws over an increasingly broad range of activity in the absence of a legislation expressly addressing insider trading. Because of this, the law has experienced confusion and ambiguity to an extent not observed in other legal domains, with the offense's components sometimes being established by court rulings utilizing specific fact patterns. This thesis examines the intricate definitions, disciplinary frameworks, and enforcement mechanisms surrounding insider trading regulations in the two largest global markets the United States and China in order to prevent illicit insider trading. However, US legal regime has been resorted to in the end owing to its historical development through hit and trial.

It has been attempted to ascertain how the development of insider trading laws in various legal systems has impacted the legal system in Pakistan through legislative actions, enforcement by pertinent agencies, and court rulings. Which set of laws continued to have the greatest impact on preventing insider trading? What shortcomings and lacuna the Pakistani legislature has attempted to fill and which still need to be addressed by the appropriate legislative or regulatory bodies? Although the idea of insider trading is not new, Pakistan's legal system is still developing when compared to other legal systems; as a result, strict regulations have not yet been implemented due to shortcomings on the parts of the judiciary, executive and enforcement agencies, and law/rule making bodies. Numerous discourses have also been adopted since insider trading began, either in support of or against it. However, the bulk of academics and theorists have abandoned theories supporting insider trading. It is rather astounding that, as a result, no theory (classical theory, tipping theory, misappropriation theory or any other relevant theory developed by common law) has ever been used in a court of law or regulatory body to implicate someone in insider corporate crime in Pakistan. The shortcomings in regulatory framework/regulations (laws encompassing acts, rules, guidelines and any other subordinate legislation) have been thoroughly examined, along with the personal opinion of which theory, if implemented in our legal system, may have a different (positive) outcome in reducing insider trading.

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CHAPTER ONE

INSIDER TRADING

1.1 Introduction

Insider trading is a form of market abuse that has existed since the beginning of the stock market. The term "insider trading" refers to the illegal trading of securities conducted by people who have access to substantial, nonpublic information about the firm whose shares are traded or the market associated with those shares.[1] Insider trading is a troubling crime because its criminology is identical to that of the majority of white-collar crimes, and its motivation can only be greed.[2] Insider trading is a transgression that is typically reported by professionals from the working class, and the main reason must be because insider trading is perceived as a straightforward, generally safe means of earning that does not harm. Insider trading, like other clerical crimes, is therefore not a common wrongdoing, and the offender is not a typical criminal. The famous criminologist Susan Shapiro stated rightly:

> *"Insider Trading like White-collar challenges the triter sorts of clarifications of criminal movement. Ta state that destitution "causes" crime, for example, flops totally to represent across the board lawbreaking by the persons who are remarkably princely. To propose that criminals need "discretion" also disregards guilty parties, for example, against trust*

[1] Langevoort, Donald C., Insider Trading: Regulation, Enforcement, And Prevention Section 3.04, At 3-22 (1999)
[2] P. Tappen, (1960), Crime, Justice and Connection, (New York: McGraw Hill).

violators and insider merchants whose lives and accomplishments speak to models of achievement through the display of restraint."[3]

The trading of shares, securities, subsidiaries, and unique instruments keeps expanding as global commercial corporate cultures continue to evolve in general markets. Insider trading is clearly a type of trade that has gained significant attention recently. Insider trading typically occurs when those who may have access to material, non-open information about a company buy or sell its stock at the exact moment the information becomes material and non-open. This type of trading is prohibited. In these situations, people consider non-open information that has been increased by the fulfillment of their promises by breaching the confidence placed in them.[4]

It is a one of the field of corporate crimes, which sociologist Edwin Sutherland first described in 1939 as an offense committed by a corporation. "A person of respectability and high social status in the course of his occupation".[5] Instead of crimes against businessmen, this approach focuses on crimes perpetrated by businessmen. While businessman crimes are the focus of attention, this is not done as an attack on business but rather as an attack on the ideas of criminal behavior that are now in place.[6]

There are winners and losers since average investors almost always act on partial or faulty information, but it's crucial that these losers do not believe they were taken advantage of for the growth and confidence of the capital markets.[7] In sophisticated capital markets around the world,

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[3] S. Shapiro in G. Geis, R. Meir, et al.(1995), White Collar Crime: Classic and Contemporary Views, 3rd Edition, (New York: The Free Press.

[4] Insider Trading Compliance Manual Biovest International, Inc. Adopted March 15, 2004, EX-99.5, https://www.sec.gov/Archives/edgar/data/704384/000119312504051976/dex995.htm last assessed March 22, 2020

[5] Crime and Business" by Edwin H Sutherland A Speech to the, American Sociological Association 27th Dec 1939.

[6] ibid.

[7] https://www.cfainstitute.org/en/ethics-standards/codes/standards-of-practice-guidance/standards-of-practice-II-A last accessed March 27, 2020

it is widely accepted that when "insiders" of a public company trade in their own company shares while possessing knowledge of significant non-public information, a market fraud has been perpetrated. This is based on the supposition that the price is set by the relevant information about the firm and its operations that is readily available in a developed and open securities market. The genuine value of the securities is distorted by misleading claims or significant commissions, which defrauds the market and, as a result, all shareholders. The argument that insider trading ought to be restricted has, however, been refuted by a number of academics, but the majority of capital market authorities in industrialized and emerging economies do not share these researchers' opinions. [8] Examining current insider trading regulations and, where necessary, making recommendations for modifications and clarification is the goal.

In any case, the two basic defenses offered by individuals who see insider trading as a legal activity are as follows: First, it is claimed that no amount of administrative and judicial resources would be sufficient to reasonably enforce a ban on insider trading.[9] This point is especially pertinent to Pakistan since insiders have access to difficult-to-detect evasion methods such the use of fictitious identities or nominees, benamis, etc. This issue is made worse by our cumbersome and ineffective legal system. The second point is that unrestricted insider trading might be seen as a crucial type of reward for entrepreneurial action. Insider trading, according to Professor Henry Manne, "is the means by which the incentives for entrepreneurial activity in large corporations is effectively preserved: the individuals in the corporation who are responsible for its successes must be able to appropriate the gains."[10]

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[8] Fisch, Jill E., "Start Making Sense: An Analysis and Proposal for Insider Trading Regulation" (1991). Faculty Scholarship at Penn Carey Law. 1036. https://scholarship.law.upenn.edu/faculty_scholarship/1036

[9] Robert J. Haft, The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation, 80 MICH. L. REV. 1051 (1982). Available at: https://repository.law.umich.edu/mlr/vol80/iss5/3 last accessed on March 29, 2020

[10] Manne, Insider Trading and Law Professors, 23 Vanderbilt L. Rev. 547 (1970).

The requirements and rules of insider trading laws are important to theorists for several reasons, including: First and foremost, corporate law analysts are probably going to be more optimistic about the financial outlooks of organizations that operate in nations with strong insider trading laws if such laws are upheld consistently. In addition, theories and methods developed in these nations may be recognized as less harmful because the knowledge is considered to be dynamically sound. Finally, theories may have a lower required level of the profit because white-collar crime and the entry theorists require on an endeavor are strongly related.[11]

Investor trust in the fairness and integrity of the securities markets is damaged by insider trading. Because of this, legislation forbidding such practice has been passed in almost every jurisdiction. Despite certain differences in the legal systems of various nations, most legislators who adopted laws addressing insider trading focused on the following issues: What is insider information? Who qualifies as an insider? What actions involving the use of insider information are forbidden? How can insider trading be stopped? What penalties and enforcement actions are necessary?[12]

It is obvious that neither all insiders nor all insider traders' employers are victimless. However, the current enforcement framework is ridiculously overbroad in that it provides no fundamental assurance to corporate insider trading victims that they won't be charged with the crimes committed against them. The law needs to be changed so that businesses may only be charged with a crime if they have committed some sort of infraction. A US court acknowledged that "there are some crimes, which by their very nature cannot be committed by corporations" in the case of N.Y. Cent. & Hudson River R.R. Co. v. United States.[13]

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[11] Beny, Laura N. "Insider Trading Laws and Stock Markets Around the World: An Empirical Contribution to the Theoretical Law and Economics Debate." J. Corp. L. 32, no. 2 (2007): 237-300.

[12] "Insider trading how jurisdictions regulate it", Report of the Emerging Markets Committee of the International Organization of Securities Commissions (IOSCO), March 2003

[13] N.Y. Cent. & Hudson River R.R. Co. v. United States, 212 U.S. 481, 494 (1909).

Insider trading is one of the most contentious and divisive issues in the economic communities; it is viewed as a kind of information theft and a breach of the public's trust. Insider trading is a phenomenon that has its roots in the history of stock exchanges. Regarding its regulation, there are two opposing viewpoints. One is in favor of deregulation, which would let corporations establish their own insider trading regulations. One group of academics' advocates deregulating insider trading so that businesses can establish their own insider trading procedures through contracts. The majority of investment decisions made in the financial sector are based on reason, but economists argue that the government should create regulations to deter and punish instances of insider information that result in losses to the national exchequer. Throughout the procedure, several psychological factors also affect and skew the decision. the influence of some components of investment decision-making on perceived risk and investment decision-making factors. The inadequate corporate governance, which does not include rules that forbid such practises, has been criticised in numerous studies. Insider trading has an impact on a company's performance and undermines the trust of its shareholders when it serves the personal interests of a select few. But does it also have an impact on investment choices. Investor survey information was utilised. Personal decisions about the purchase of low-cost securities made specifically for the owner's account are linked to individual investing decisions. Inside information is typically defined as important, previously unreleased, nonpublic, or price-sensitive information that (directly or indirectly) relates to a specific listed security. Furthermore, if information of this specific sort were made public, it would significantly affect the company's stock values.

The Bottom Line is that Insider trading happens when non-published information from a company is used to make a trading decision by someone with an invested interest in that company. It is

illegal to engage in insider trading, but it is legal to trade your company shares as long as you follow the guidelines set by the Securities Exchange Commission.

1.2 What is an 'Insider Trading'?

An insider trading occurs when someone trades shares of the company on the basis of confidential, price-sensitive information.[14] Such trading makes use of private knowledge, making it unethical and effectively betraying the fiduciary position of trust and confidence.[15] The basic elements of insider trading are:

(i) engaging in a securities transaction,

(ii) possessing of material non-public information,

(iii) violating a duty to refrain from doing so.

Examining the aforementioned criteria, the following six requirements must be met for insider trading: 1. The parties to the transaction both have valuable inside information; 2. The information is typically not available to regular financial experts (non-insiders); 3. information made public by the organization; 4. an individual exchanges shares solely on the basis of such information; 5. an individual approaches the information within the scope of an insider; and 6. Accordingly, the trader should have actually avoided unfavorable outcomes or accrued unusual benefits.

Information that is both non-open and material is referred to as inside information. Two considerations should be given to insider information's matter and confidentiality. Information is

[14] Carlton, Dennis W., and Daniel R. Fischel. "The regulation of insider trading." Stan. L. Rev. 35 (1982): 857. Available

[15] Vyas Amit K. (2006), "Insider Trading : Review of Some Important Cases, Chartered Secretary, ICSI, August 2006, pp-1133-1138

considered confidential until it is made publicly available.[16] To make the rule of privacy following ingredients ought to be considered:

i. Requirements of strict divulgence;

ii. The method for influencing the information to wind up open;

iii. The burden of trading stops or prerequisite for insiders not to exchange until the point when financial specialists have the chance to survey and follow up on distributed information;

iv. Reporting of insiders' exchanges;

v. Restrictions on insider trading in periods near an arrival of inside information;

vi. Regulations to keep go-betweens from tolerating orders showing conceivable insider trading movement;

vii. Directions to expect issuers to receive techniques for taking care of inside information which would make it conceivable to decide the personality of persons who procured inside information and the time at which they obtained it.

All of these regulations link insider trading to market manipulation even though the two ideas are separate. The similarity between both is that in both instances "Innocent investors may potentially acquire or sell stocks at a false price as a result of insider dealing or market manipulation. Furthermore, this form of market manipulation erodes consumer faith in markets."[17] Bainbridge says, "Manipulation of stock prices, as a form of fraud, harms both society and individuals by decreasing the accuracy of pricing by the market."[18] Insiders are thought to have the greatest incentive to engage in market manipulation because they have a "strong interest in maintaining

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[16] V Brudney Insiders, Outsiders, and Information Advantages under the Federal Securities Laws Harv. L. Rev , volume 93 Posted: 1979

[17] Consultation Paper No. 6, Paper 2003-06, Market Manipulation and Insider Dealing (Jersey financial Services Commission, 2006), 6.

[18] Ibid.

the stock pricing stability or in moving it in the right direction while they are trading," according to those who support regulating insider trading."[19] Even the main opponent of insider trading rules admitted this. Manne said that manipulation is bad and that it would stop if insider trading were completely outlawed since no one would stand to gain from it.[20] The detrimental effects of insider trading can be better understood as follows:

(i) It damages speculators' faith in the morality and reliability of the capital markets;

(ii) It benefits a select group of privileged individuals while harming normal investors;

(iii) It diverts the flow of foreign exchange, which is now the cornerstone of several industries.

A vast range of defenses against insider trading have been devised by detractors. An empirical question is whether insider trading has more negative effects than positive ones. There is a strong implication that insider trading may be advantageous in some situations given the apparent lack of widespread restrictions of the activity in employee contracts and corporation charters and the existence of common law principles authorizing it.[21]

Insider trading, according to many observers, is harmful because it allows insiders to profit from negative news, which generates a moral hazard. At the extreme, they contend that allowing insiders to profit from false information renders managers indifferent to whether they should endeavor to make the company successful or bankrupt. Another variation of this argument contends that insider

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[19] Ibid. quoting Schotland, "Unsafe t Any Price: a Reply to Manne, 'Insider Trading and the stock market '" 53 Virginal law Review 1425 (1967), at 1449-1450.

[20] Ibid

[21] Carlton, Dennis W., and Daniel R. Fischel. "The regulation of insider trading." Stan. L. Rev. 35 (1982): 857. Available at https://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=2424&context=journal_articles [Assessed on 6 November 2021]

trading incentivizes insiders to spread untrue information about the company in order to profit from the purchase and sale of mispriced stocks.[22]

1.2.1 Types of Insider Trading

1.2.1.1 Types of Insider Trading Related to Positivity or Negativity of Information

The insider trading may be categorized on the basis of divergence of information. That is positivity or negativity of information. [23] Insider trading aimed at "price increasing" is regarded as the first type of positive information. Non-whistleblower information is considered to be positive, whereas "price-decreasing information" is considered to be the second category of negative information. And the negative information is essentially the facts disclosed by a whistleblower.[24]

This qualification is important when discussing insider trading, but the text has not given it any attention. In the end, most academics agree that cost-decreasing and cost-expanding insider trading should be controlled proportionately; either both should be regulated or neither should, according to verifiable evidence.[25]

Since stock prices had long been perceived as being close to fundamental values, the benefits of insider trading to the accuracy of stock prices were not given much consideration. Nevertheless, this miscalculation does not advocate for a demand for complete deregulation, permitting insider trading for the most part. Or perhaps offer cost variations have become more likely on the upside, leading to an increase in overvaluations (also known as "positive stock air pockets"). This analysis emphasizes the significance of insider trading on negative information rather than insider trading

[22] Ibid,.

[23] Jill E. Fisch, Start Making Sense: An Analysis and Proposal for Insider Trading Regulation, 26 GA. L. REV. 179 (1991)

[24] Carlton, Dennis W., and Daniel R. Fischel. "The Regulation of Insider Trading." Stanford Law Review 35 (1983): 857-95.

[25] Dooley, Michael. "Enforcement of Insider Trading Restrictions." Virginia Law Review 66 (1980): 1-83.

on good information because there may occasionally be few compelling incentives to remove overvaluations.[26]

Negative information is typically kept a secret longer than positive information. In this way, the insignificant incentive provided by a legislation allowing insider trading for insiders to disseminate information by trading is more obvious in the case of disseminating negative information than good information. Insider trading prohibitions, which are firmly associated with this idea, support insiders' cunning assents to conceal damaging knowledge. Because of the chance that their co-schemers will report them to the SEC due to these disallowances, those who plot are given permission to engage in improper behavior, which allows for the requirement of illegal agreements.[27]

However, a few economists have recognized the crucial distinction between trading on positive insider information and trading on negative insider information, and they have looked into the appeal of an insider trading management system that continued to manage cost-expanding insider trading in the conventional manner while providing no (or less strict) direction of cost-decreasing information. According to a clear explanation of an unfair approach to dealing with insider trading regulation, opposing legal treatment for the aforementioned two types of trading was encouraged by the fact that cost-decreasing insider trading provides financial experts with a fundamentally greater incentive than priced expanding insider trading.[28]

By requiring timely public disclosure of these exchanges after they are completed, the impact of cost-decreasing exchanges would be lessened because authorities would be less likely to "divert"

[26] The arguments in this research regularly incorporates the two boundaries: forbidding insider trading on positive and negative information without earlier disclosure of nonpublic information and permitting insider trading on positive and negative information without earlier revelation of non-open information.

[27] Supra 21,.

[28] Lambert J. H. Jennings R. K. Joshi N. N. "Integration of Risk Identification with Business Process Models,". International Journal of Systems Engineering, 9 No. 3, (2006). 187–198.

the framework through important trade. Lambert argued that most agreements would lead to the selection of alternative administrations under such a system, where insiders might make cost-reducing swaps provided they rapidly disclosed the exchanges to the public.[29] According to instances like SEC v. Texas Gulf Sulfur Co.[30] and United States v. O'Hagan[31], insider trading on bad news has a stronger societal incentive than insider trading on good news. In reality, customary legal penalties for insider trading that were based on a breach of trustee duties typically required a comparable refinement. [32]

This study challenges conventional wisdom by focusing on the idea that insider trading should only be allowed in situations where informational points of interest are at their highest. It also highlights the effectiveness of insider trading on positive information.[33] That contends that insider trading on the basis of positive information should be acceptable and insider trading on the basis of negative information should be prohibited in contrast to this research idea.[34]

1.2.1.2 Types of Insider Trading Relating to Legality & Illegality

Arguments for and against insider trading activities are both available. There are two types on the basis of legality; Illegal Insider Trading & Legal Insider Trading.

a. Illegal Insider Trading

Four contentions that include insider trading are

i. Unbalanced information,

[29] Ibid.
[30]SEC v. Texas Gulf Sulfur Co.,[30] 401 F.2d 833 (2d Cir. 1968)
[31]United States v. O'Hagan, 521 U.S. 642, 651 (1997).
[32] Daniel R. Fischel, InsiderTrading and Investment Analysts: An Economic Analysis of Dirks v. Securities and Exchange Commission, 13 HOFSTRA L. REV. 127 (1984)
[33] Lucian Arye Bebchuk & Chaim Fershtman, The Effect of Insider Trading on Insiders' Reaction to Opportunities to Waste Corporate Value (Nat'l Bureau of Econ. Research, Working Paper No. 95, 1991).
[34] Victor Brudney, Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws, HARV. L. REV. 93 No. 322 (1979).

ii. On a basic level access to information,

iii. Misappropriation and

iv. Absence of guardian duty.

The most well-founded of these four claims has been found to be trustee obligation. The securities market needs to have incredible information preparation capabilities in order to be effective. It is essential that investors have the opportunity to deal with at least exchange costs. It is widely acknowledged that both organizations and the general public value the benefits of accurate security evaluation. The market would determine the "right" price for security if all relevant information about it had been made publicly available. The general public benefits from accurate evaluation through a more equitable allocation of capital and a reduction in the unpredictable nature of security expenses.[35] The level of corruption filth is also reduced as a result of an accurate assessment of its defenses, which is made possible by a reduction in financial specialist vulnerability and an increase in the scrutiny of administrative competence. People who are closely associated with the organizations have a crucial role in creating market vulnerability. Trading with insider information is prohibited in a significant chunk of the world's securities regulations. Insider trading restrictions were adopted in the USA in 1934. Insider trading is frequently blamed for lowering speculators' faith in the market. Numerous faultfinders identify the stringent requirement of insider trading regulations as the cause of the United States' enormous foreign interest.

b. Legal Insider Trading

There are disagreements over the legal implications of insider trading. Some supporters claim that insider trading is completely legal. Some scholars and experts believe that insider trading

[35] Bainbridge M. Stephen, Securities Law: Insider Trading, (New York: Foundation Press, 1999), p-129.

restrictions should be abandoned since they allow for the instantaneous integration of private information into stock prices, increasing the effectiveness of stock prices as a source of information.[36] In an interview, Milton Friedman opined that:

> *"you want more insiders trading not less; you want to give the people most likely to have knowledge about deficiencies of the companies and incentives to make the public aware of that."*[37]

The consequences of insider trading legally are a matter of debate. Insider trading, according to some proponents, is entirely lawful. Insider trading limitations, in the opinion of some academics, should be eliminated since they enable the rapid integration of confidential information into stock prices, enhancing the usefulness of stock prices as a source of information.[38]

Many investors believe that insider trading is forbidden. This confusion arises because some insider deals are illegal while others are completely legal, that is, inside as much as feasible.[39] Only a few specific types of insider trades are prohibited by law, but the vast majority of insider trading is permitted. Some observers mistakenly believe that if insiders make money, it must be illegal.[40] Manne, as well as more recently other financial professionals like Martin and Peterson, speak on the philosophy that supports insider trading. They made a wonderful set of arguments recognizing the financial effectiveness and fascinating nature of insider trading.[41]

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[36] Carlton D. and R. Fischel, "The Regulation of Insider Trading", Stanford Law Review, Vol.-35, (1983), pp-857-95.

[37] CNN interview dated January 17, 2002.

[38] Brudney, Insiders, Outsiders and Informational Advantages under the Federal Securities Law, Harvard Law Review, VoL-322, (1979), pp-356-357.

[39] Henry Manne, Milton Friedman, Thomas Sowell, Daniel Fischel, Frank E. Easterbrook

[40] Seyhun Nejat H. Investment Intelligence from Insider Trading, (The MIT Press, 1998), p-xxvi.

[41] P/E or Price Earnings Ratio is figured as the current stock cost partitioned by the income per share over the previous years, B/M or Book to Market Ratio is registered as the book estimation of value separated by the current stock cost and it subsequently contains the current stock cost in the denominator. The profit yield is figured as the measure of profit per share separated by the current stock cost.

On defense, Manne said that because it encourages entrepreneurial growth, insider trading is financially beneficial.[42] Any excessive insider trading will be controlled by the stock market itself. That argument focuses on the premise that each market, if left uncontrolled, will find equilibrium at the perfect point and alludes to Adam Smith's renowned "undetectable hand." Insider trading helps businesses succeed.[43] In new organizations, the division of ownership and control necessitates the establishment of administrative motivational forces and that may happen at the cost of Insider trading.[44] Contrarily, opponents of insider trading restrictions, including Milton Friedman, a recipient of the Nobel Prize in economics, argue that insider trading is ideal and that there should be more of it rather than fewer.[45] This type of trading is known as lawful insider trading when an organization's own insider trades its securities within a permissible threshold or within the controls. In this case, business insiders such as officers, executives, and representatives are permitted to buy and sell stock in their own companies. Different countries have different arrangements of insider trading laws and regulations in this way. Insiders in the USA, such as officers, directors, and representatives, are allowed to buy or sell shares in their own companies up to 10% of a class of securities, but they must report to the SEC.[46]

1.3 What Constitutes an "Insider"?

An "insider" is an officer, director, 10% stockholder and anyone who possesses inside information because of his or her relationship with the Company or with an officer, director or principal stockholder of the Company.[47] The scope of application of Rule 10b-5 extends much beyond

[42] Henry G. Manne, Insider Trading and the Stock Market, (New York: The Free Press, 1966), p. 120.
[43] Ibid, p. 110.
[44] Carlton D. and R. Fischel (1983), Op. Cit. Pp- 857-895
[45] Friedman argued this in 2003, in an interview called Trust markets to weed out corporate wrongdoers. The transcript is unavailable, therefore the argument is taken out of the paper of Hotson et al., (2008)"
[46] Section 12 of the Securities Exchange Act, 1934, USA.
[47] Rule 10b-5, SEA 1934, USA

officers, directors, and substantial stockholders. This rule also applies to any employee who obtains significant non-public corporate information or who receives a "tip" from a company insider regarding significant non-public information about the company and trades (i.e. buys or sells) the company's stock or other securities.[48]

This rule also applies to trusts or other organizations for which you make choices regarding investments, as well as to your family members who live with you, anyone else who lives in your home, and your family members who do not live in your home but whose securities transactions are under your direction, impact, or command.[49]

Statutory definitions of what constitutes an "insider" for the purposes of insider trading laws may be based on either a "person connection" approach or an "information connection" approach. The "person-connection" approach characterizes "insider" by reference to the relationship of the person to general security issuer of securities, while the "information connection" approach considers any individual who has material value touchy information about the issuer to be an insider, paying little heed to association with the issuer.[50]

Insider trading in the US relied on the custom-based law activity for dishonest transactions prior to legislation specifically banning it. The self-described "special circumstances" theory, which depends on the presence of a link between executive and investor that is not the same as the tie between merchants, was stated by the Supreme Court of America in Strong v. Repide.[51] In this instance, the property of a minority investor was acquired by a controlling investor and general supervisor of a partnership without disclosure of the transactions' then-current status in exchange

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[48] https://www.sec.gov/Archives/edgar/data/1164964y last assessed March 22, 2020

[49] Ibid.,

[50] Mak, Yuen Teen and Sequeira, John M. and Lan, Luh Luh and Tan, Jocelyn, Does the Adoption of an Information-Connected Approach Reduce Insider Trading? (July 6, 2008). 21st Australasian Finance and Banking Conference 2008 Paper, Available at SSRN: https://ssrn.com/abstract=1156143 or http://dx.doi.org/10.2139/ssrn.1156143

[51] Strong v. Repide, 213 U.S. 419 (1909).

for the offer of corporate resources. The respondent was given the authority to use corporate resources, which was seen to be one of the "special circumstances"; if he had not been an executive, he would not have been under any legal responsibility to divulge information.[52]

As far as legislation of Insider trading in Pakistan is concerned, it has also adopted the person connection approach. According to the Listed Companies (Prohibition of Insiders Trading) Guidelines of 2001, an "insider" is defined as a person who holds directly or indirectly not less than 10% of the shares of a listed company or who is a director, chief executive, managing agent, chief accountant, secretary, or auditor of a listed company. Additionally, a "insider" is defined as a person who is or was connected to the company or is deemed to have been connected to the company.[53]

1.3.1 Categories of Insiders

Insiders have been characterized under two classes, Primary insiders and Secondary insiders;

1.3.1.1 Primary Insiders

Individuals who receive information directly from its original sources and possess the necessary knowledge to access the information's materiality are referred to as primary insiders. They are trusted to understand the results of trade based on confidential information. Primary insiders include members of the issuer organization's management, supervisory, or authoritative groups, as well as its employees and those who provide services to the issuer organization, such as outside attorneys, bookkeepers, and financial advisors.[54] Under US controls, the concept of primary insiders refers to certain individuals, such as officers, top executives, and representatives, who have a trustee obligation. Insiders also include beneficial investors under their definition. In any

[52] Louis Loss, Fundamentals of Securities Regulation (1983) 818-819
[53] Listed Companies (Prohibition of Insiders Trading) Guidelines of 2001, Section 2, Clause (g).
[54] Kenneth Scott, Insider Trading: 10b-5, Disclosure and Corporate Privacy, LEGAL STUD.9 J. No. 801, (1980).

case, the level of shareholding varies per country. In China, those who own 5% of an organization's shares are also classified as insiders. In Hong Kong, a significant number of investors are considered insiders, compared to 10% in Hungary.

1.3.1.2 Secondary Insiders

Some people are referred to as secondary insiders because they receive inside information from another individual. Due to a special relationship with a person who is knowledgeable about the subject, they can learn this information. Those who receive information from a primary insider are referred to as "tippees." Tipping is the act of a key insider providing substantial undisclosed information to a second group so that group can discuss it. Tippees are not allowed to share this information with one another. [55]A person is considered as an "accidental insider" if they get inside information by unusual circumstances rather than approaching it directly or receiving a tip from someone who does. Such instances include overhearing a conversation on a cell phone or in the elevator, discovering sensitive documents in the garbage, accepting an email or copy sent to the erroneous number, and so on.[56] When evaluating whether they have harmed insider trading practices, their expectation to exchange relies on inside information. Several factors support the legitimacy of such a qualification. Primary insiders initially obtain information from their own sources and possess the necessary knowledge to reach the information's substance. They must also be able to understand the effects of trading on private information. Therefore, the punishment meted out to primary insiders is usually far heavier than the punishment meted out to secondary insiders.

[55] An accidental insider is an unplanned person that neither approaches inside information nor was tipped by a person who approaches such information yet learned inside information because of unique conditions.
[56] IOSCO Report (2003) Op. Cit, p-9

1.4 What is an 'Inside Information'?

According to Pakistan's 2015 Securities Act, Part X, "insider information" is defined as "information that has not been made public and relates directly or indirectly to at least one issuer of registered securities or to at least one registered security and that, on the rare occasions that it were made public, would potentially impact the prices of those registered securities.".[57] The SECP has made it compulsory for organizations to record the name of persons approaching inside information.[58] Information is considered "inside information" if it has a sensitive value and has not been made public.[59] Trading by corporate insiders, such as officers, key employees, executives, and significant investors, may generally be legal if it is carried out without taking use of non-open information. The legal requirements to discover inside information are essential to the regular operation and credibility of the money markets and assist the upkeep of a fair, clear, and informed market. Insider information is referred to as "material non-public information" in the USA. Below are the components of this meaning that will be considered:

1.4.1 Materiality

According to the rulings in TSC Industries Inc. v. Northway[60] and Basie Inc. v. Levinson,[61] information is material if there is a high likelihood that the disclosure of the information would be perceived by the investor as having fundamentally changed the overall mix of the information made available. Even if the US Supreme Court did not define the term directly in the context of insider trading, information might nevertheless be deemed as material even if it just suggests a small possibility of a specific event occurring. In SEC v. Texas Gulf Sulphur Company,[62] for

[57] Section 129, Securities Act, 2015
[58] Access to Insider Information Regulation, 2016 in compliance of Part X of Securities Act, 2015
[59] Section 15D, Securities Exchange Ordinance, 1969
[60] TSC Industries Ine. v. Northway, 426 V.S. 438 (1976).
[61] Basie Inc. v. Levinson, 485 V.S. 224,232 (1988).
[62] SEC v. Texas GulfSulphur CO, 401 f.2d 833 (2d Ciro 1968).

instance, the material that raised concerns was a favourable report relating to the mining industry. The court believed that the information would have been crucial to a prudent financial expert, however the main example court found that the information was too remote to have any meaningful impact on the organization's securities. The findings of the investigative court must be appropriate in this case. However, it is impossible to find a plaintiff who has immediately purchased a sizable number of stocks after obtaining the information for themselves and assures that it is immaterial.

1.4.2 Non-Public Information

Information is private until the markets have had enough time to completely "digest" it. There are two main perspectives on what this means. The number of people to whom the material has been revealed is irrelevant, according to first source courts. As stated by the court in United States v. Liberia, the information must instead have been factored into the market price of the securities for it to no longer be considered "non-public.".[63]

The SEC's position, which is the opposing one, is that in order for material to be considered open, it must have been disclosed in an open manner through an appropriate open source. Specifically, "by a public release through the appropriate public medium." [64] On the surface, this hypothesis seems more appealing. Determining when information has been made public vs determining when the market price of a security has stabilized is obviously simpler for a dealer. Furthermore, it is unreasonable to deny an insider the right to exchange stocks based on publicly available knowledge. In any case, the SEC has exaggerated the meaning. In one instance, an insider was in charge of trading based on information that had been revealed in a formal statement two weeks earlier because the SEC believed that the Wall Street Journal story in which the information

[63] United States v. Liberia, 989 f.2d 5969 601 (2d Ciro 1993).
[64] In re Faberge Inc.• 45 S.E.C. 249, 256 (1973).

ultimately surfaced was the appropriate open source. In the decision in United Sales v. Teicher,[65] this was suggested. Evidently, this is inappropriate considering that specifying open disclosure would be straightforward and result in substantially greater clarity and civility for investors or traders.

1.5 Evolution of Insider Trading

Insider trading is a form of market abuse that dates back to the origins of the securities markets. According to interpretations of the term's definitions, insider information is information that has not been disclosed freely, generally, directly or indirectly, explicitly or implicitly, to the issuers of securities that could have an impact on the costs and prices of the influenced securities. It is pertinent to track out its historical evolution in international as well as Pakistani backgrounds. Even though the notion of "Insider Trading" has existed in the American stock market since William Duer, a US Assistant Secretary of the Treasury, used his position to purchase the "right" bonds that produced significant profits for him in the late 1700s, it wasn't until the 1920s that many Wall Street professionals and even some members of the general public began to voice concerns about the way in which American bourses were rigged by powerful investing pools. However, the United States was the leading nation in outlawing insider trading based on material non-public information until the 21st century and the European Union's market misuse rules.[66]

It is interesting to believe that the First US Congress added the boycott clause to the Treasury Department establishment bill in 1779 because it was widely believed that there was a relationship between dealing in securities and political dereliction of duty. The ensuing Act stated that officials and representatives who violated any of its provisions would "be considered liable of a high

[65] United States v. Teicher 987 F.2d 112 (2d Cir.), cm denied, 114 S.Ct 467 (1993).

[66] https://www.thenews.com.pk/print/256872-tareen-lucky-as-sc-didn-t-dig-deep-into-insider-trading last accessed June 07, 2020

wrongdoing," pay a $3,000 fine ($500 in the assistant's case), be removed from office, and be prohibited from holding any future public office. A individual who provided the legislature with information that led to a conviction could get half of the fine. Stuart Bansner argues that the passage of the Act solidified the primary prohibition in English or US law of what might significantly later (and frequently with reference to corporate stock as opposed to general society obligation) come to be known as insider trading, despite the fact that there have been no publicly reported instances of anyone consistently having been indicted under the Act for more than two centuries.[67] Accordingly, statutory regulations and court adjudications have over time modified the definition of insider trading and who qualifies as an insider.[68]

The United States Supreme Court declared in 1909, long before the Securities Exchange Act was enacted, that a corporate director had committed fraud by purchasing the stock of his company when he knew the price was due to rise without reporting his inside knowledge.[69] Insider trading is an issue that has been the subject of extensive, sophisticated debate since the 1960s, according to research into historical arguments and debates.[70] As a result of the conclusion of numerous legal conflicts involving the subject of insider trading, numerous landmark legal precedents have been established, which have resulted in the creation of landmark statutes. These precedents include the case *United States v. O'Hagan,* [71] *Dirks v. SEC,*[72]and *Chiarella v. United States.*[73]

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[67] Stuart Banner, Anglo-American Securities Regulation: Cultural and Political Roots, 1690-1860 (1998) 161-164.
[68] See Supra Note 19, p. 3
[69] Strong v. Repide (1909)
[70] E.g., HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (The Free Press 1966); Stephen Bainbridge, The Insider Trading Prohibition: A Legal and Economic Enigma, 38 U. FLA. L. REV. 35 (1986); Dennis W. Carlton & Daniel R. Fischel, The Regulation of Insider Trading, 35 STAN. L. REV. 857 (1983); Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, 1981 SUP. CT. REV. 309. For useful summaries of the debate, see generally Charles C. Cox & Kevin S. Fogarty, Bases of Insider Trading Law, 49 OHIO ST. L.J. 353 (1988) and Boyd Kimball Dyer, Economic Analysis, Insider Trading, and Game Markets, 1992 UTAH L. REV. 1.
[71] United States v. O'Hagan, 521 U.S. 642 (1997).
[72] Dirks v. SEC, 463 U.S. 646 (1983).
[73] Chiarella v. United States, 445 U.S. 222 (1980).

The USA's enactment of Securities Trade Act of 1934, which was the product of the purported "New Deal" following the 1929 financial crisis, planted the seed of insider trading. A limited category of insiders is required to declare their transactions in the securities of their companies under Section 16 of the 1934 Act, as well as any benefits they received during a six-month period. Officers or directors of organizations with a class of value securities classified under the 1934 Act, as well as beneficial owners of 10% or more of such securities, are insiders to whom this arrangement applies.[74]

Despite the fact that the purpose of section 10(b) of the 1934 Act[75] was not initially to prosecute insider trading, the Securities and Exchange Commission (SEC)'s creation of Rule 10b-5[76] under that provision in 1942 has had a significant impact on the development of insider trading law. The use of manipulative or deceptive devices in connection with the purchase and sale of securities on stock exchanges is prohibited by Rule 10b-5. According to the applicable clause, it is illegal for anyone to use any method or scheme to commit fraud by making false statements or misrepresenting the truth in order to sell or purchase any stock. [77] The rule itself doesn't specifically mention insider trading or define what an insider is. However, because there isn't a clear-cut, authorised definition of what "insider trading" is, the SEC is free to create its own definitions, which are then susceptible to judicial scrutiny.[78]

Inside information is described as information that "(1) relates to particular securities or their issuers; (2) is specific or precise; (3) has not been made public; and (4) if it were made public would be likely to have a significant effect on the price or value of any security," according to the

[74] Report of the Emerging Markets Committee of the International Organization of Securities Commissions (IOSCO), March 2003, p-30

[75] 15 U.S.C. 78j (2016).

[76] 17 CFR 270.10b-5 (2016).

[77] SEC Rule 10b-5, 17 CFR 240.10b-5 (1942).

[78] Louis Loss, Supra Note 23, 39

definition used in the developed (UK, Germany, etc.) and developing (China, Pakistan, etc.) countries[79].German law defines an "insider fact" as "Knowledge of a fact not generally known relating to one or more issuers of insider securities or to insider securities, which fact is capable of substantially influencing the price of the insider securities in the event that it becomes generally known."[80] Laws in other countries also specify what constitutes privileged information or an inside fact[81]. Other crucial categories are also defined under the legislation, including those who are insiders, have a "special relationship" with the corporation, or have "access" to nonpublic information, among others.[82] It should not be surprising that these laws demand the resolution of conceptual issues. When, in the context of the UK, is knowledge "particular or precise" (as opposed to being general or unspecific)? Is it true or not clear enough under the statute that the subject company is in early merger discussions with a possible bidder?[83] When is a fact not well known enough to be considered an "insider fact" under German law?[84]

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[79] Criminal justice Act 1993 (CJA), 36, part V, §§ 56, 60(4) (Eng.), as set forth in Alistair Alcock, United Kingdom, in INTERNATIONAL SECURITIES REGULATION vol. 6, bklt. 1, 27 (Robert C. Rosen ed., 1994).

[80] Securities Act § 13. Tony Hickinbotham & Christoph Vaupel, Germany, in INTERNATIONAL INSIDER DEAIING 129, 134 (Mark Stamp & Carson Welsh eds., 1996).

[81] France-Law No. 90-08, J.O., July 20, 1990; Italy--Consolidated Act on Financial Intermediation art. 180, para. 3, implemented by CONSOB Regulation No. 11520.

[82] , Directive, supra note 9 ; Australia--Corporations Law § 1002G(l); Canada-Ontario Securities Act § 76(1), 76(5).

[83] The ambiguity of the United Kingdom's definition of inside information has been criticized. See Hickinbotham & Vaupel, supra note 92, at 100. Note that the French judiciary has held that "privileged information" encompasses negotiations relating to a prospective takeover offer by a French company seeking to acquire the securities of a publicly held U.S. corporation. See CA Paris, 6 July 1994, Les Petites Affices (PetitesAffiches) No. 137, 16 Nov. 1994, p. 17, note Ducouloux-Favard, discussed in Patricia Peterson, France, in INTERNATIONAL INsIDER DEALING 152, 156 (Mark Stamp & Carson Welsh eds., 1996).

[84] e Hartmut Krause, The German Securities Trading Act (1994): A Ban on Insider Trading and an Issuer's Affirmative Duty to Disclose Material Nanpublic Information, 30 INT'L LAw. 555, 562 (1996) ("Neither the German Act nor the EC Insider Trading Directive offer guidance as to when information should be considered known to the public.") Cf. Australian Corporations Law § 1002B(2) (setting forth that information is generallyavailable if "(a) it consists of readily observable matter; or (b) without limiting the generality of paragraph (a), both the following subparagraphs apply: (i) it has been made known in a manner that would, or would be likely to, bring it to the attention of persons who commonly invest in securities of bodies corporate of a kind whose price or value might be affected by the information; and (ii) since it was so made known, a reasonable period for it to be disseminated among such persons has elapsed").

International press reports indicate a growth of legislative and regulatory initiatives targeted at limiting insider trading in just the last few months in nations all over the world. For example, in 1998 alone Hong Kong regulators announced new insider trading prevention measures, including the adoption of new electronic surveillance technology;[85] For the first time, investors in Malaysia now have a private right of action against insider traders because of changes made in the country's securities legislation.;[86] The Securities and Exchange Board of India passed regulations requiring that business transactions be notified to stock exchanges within 15 minutes of completion as part of its campaign to combat insider trading;[87] A decree establishing Vietnam's first public securities market was made public, and it contains restrictions on insider trading;[88] The Cairo Stock Exchange's regulation is being completely reformed by the Egyptian government to bring it into compliance with international norms;[89] The Amsterdam Exchanges' mechanisms for identifying and looking into insider trading are being examined, according to a report from the Netherlands Securities Board.[90] These changes usher in a new era of widespread understanding that insider trading "has utterly no place in any fair-minded law-abiding economy," in the words of SEC Chairman Levitt.[91]

As far evolution of insider trading laws in Pakistan is concerned, the main source of the law on insider trading was the Securities and Exchange Ordinance, 1969 (Ordinance No. XVII of 1969).[92]

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[85] Stewart Oldfield and Sauw Yim, Regulators Aim to Hit Market Regulation, South China Morning Post, July 22, 1998, at 1.
[86] Munir: Amendments to Promote Transparency, New Straits Times-Management Times, June 17, 1998.
[87] Indian Watchdog Makes Negotiated Deals More Transparent, Asia Pulse, August 13, 1998.
[88] Jonathan Birchall, Hanoi Decree on Exchange, Financial Times, July 15, 1998.
[89] Global Regulations: Financial Reforms in Germany, Egypt, Philippines, EIU ViewsWire, April 9, 1998.
[90] Netherlands Securities Board to Investigate Amsterdam Bourse Systems, AFX News, July 22, 1998.
[91] Arthur Levitt, A Question of Investor Integrity: Promoting Investor Confidence by Fighting Insider Trading, Address Before the "SEC Speaks" Conference, February 27, 1998.
[92] The latest version of the Ordinance can be found on the SECP website: http://www.secp.gov.pk., last accessed on 23.3.2021

The prohibition of insider trading was inserted through an amendment introduced by the Finance act, 1995. Later on, Listed Companies (Prohibition of Insider Trading) Guidelines were issued in 2001 by SECP. In January 2015, a government Bill was passed by Senate of Pakistan to promulgate Securities Act, 2015, aimed to remove gaps in the previous laws.[93] Securities Act 2015 was one of the most awaited and anticipated legislation, more extensive than its predecessor. It was intended to eliminate inadequacies, lacunas in the 1969 SEO, and to reform the grey areas in the law. It was hoped to bring an exhaustive, broad, and ample regulation. [94] The latest Regulation passed/issued/notified by SECP is 'Access to Inside Information Regulation, 2016' according to which there is Prohibition to conclude any transaction on the basis of Insider Information and it is obligatory upon the person to get enlisted as per the format provided by SECP in Compliance of Part X, Securities Act, 2015[95]

Now, the queries arise; Whether the Securities Act, 2015 weeds out the old inequities related to the insider trading? If we go through the bit of history we come across several handy examples from United States where renowned stock market brokers and business tycoons were questioned, convicted, sentenced and fined by courts for capital market manipulations but, in case of Pakistan the conviction on trial of Insider trading remained only a theory.

1.6 Thesis Statement

> *"Many regulations have been passed in Pakistan to build confidence of investor(s) by promoting principle of fairness in securities market but such regulations are still required to be analyzed in order to*

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[93] Securities Act 2015 Available at http://www.senate.gov.pk/en/index.php (Last accessed May 6, 2018).
[94] Key issues addressed in this law are strict prerequisites of accreditation for all market participants inclusive of the exchanges, the clearing company, the CDC, stock dealers, intermediaries, syndicates, mediators, prevention of Inside Information abuse and deceptive and manipulative techniques
[95] Access to Inside Information Regulation, 2016

check its effectiveness, especially, when we compare such regulations with legal regimes of USA & China, focusing more on USA being the bastion of regulating insider trading by and far more than a century period simultaneously through both common law and Congress (plus SEC)."

1.7 Research Question

Q.1. Whether definition of insider is adequate enough to comprehend all sort of Insider who may corrupt/leak the non-public material information? Should the definition incorporate a "person-connection" as well as "information-connection" approach? Whether other than price sensitive information be considered as Insider Trading? How evolution in different countries, especially US, has played significant role in curbing Insider Trading?

Q.2. Whether the regulators have critically applied the lens of Insider Trading theories i.e., Classical Theory, Tipping Theory, Parity of Information Theory & Misappropriation Theory, while legislation, keeping in view the development of Insider Trading law in USA being pioneer in development of Insider Trading law? If not, then what would be the ramifications of such legislation?

Q.3. Securities Act, 2015 was promulgated with the intension to eliminate inadequacies/lacunas in the law by clearing the grey areas in the Insider Trading law. Has Pakistani Regulatory framework designed in a way to comprehend all elements/ingredients of the definition of Insider Law in successive legislations? If not, what role Pakistani courts have played to address the issue since US courts (common law) have played positive role by putting forward many theories to outlaw insider trading?

Q.4. How the two big economic giants i.e., US & China, have enforced their regulatory framework to curb Insider Trading in Securities? Which model would be suitable for Pakistan in the current scenario after analyzing empirically both legal regimes?

Q.5. Is it justified to compare US model with that of Pakistan? If yes, what would be the challenges in implementing the regulatory framework after finding lacunas in Pakistani legal setup? What repercussions has followed owing to flaws in regulatory and enforcement mechanism? What would be the plausible recommendations for improvement?

1.8 Scope & Objective of the Study

The existing laws on insider trading in Pakistan, US and China have been examined separately first. Later on, empirical analysis of US corporate regime with that of China (going to be the biggest economic giant in future) is done. Scope of comparative analysis of Pakistani corporate legal regime has been limitized to that of US specifically in the end to suggest amendments and clarification where appropriate. The main objective of this exercise was unwrap the cost benefit of introducing such regulations and to emphasize the introduction of effective protection mechanism in order to minimize the risk and the likelihood of market manipulation and insider trading. Potential compliance measures include policies, monitoring mechanisms, awareness training, and appropriate sanctions to be exhaustively and comprehensively analyzed. The major objective of the study is to find out why there is paucity of insider trading cases and, even if, let's say, the litigation start, why there is lack of convictions against insider trading offences in Pakistan. Limitation to the extent of pertinent issues like definition clause in the enactment/regulation of insider trading, enforcement mechanism. Moreover, common law interpretation on the subject have been examined whether Pakistani courts have bothered to apply any insider trading theories while adjudicating the insider trading cases.

1.9 Significance of Research

The contribution of this thesis is to find the gap and augment the definitions of insider trading in all enactments of Pakistan legal framework in the light of various insider trading theories. Moreover, this thesis would fill the gap by investigating whether government regulations can be effective in deterring insiders from trading on inside information. The focus is on major problems faced by SECP to contain insider trading and then suggesting the way out. It will help in gaining quid pro quo benefit from Insider Trading specialists if suspected cases of market manipulation or insider trading occurs despite all precautions adopted by Insider Trading specialists even though Insider Trading forensic experts have specialty to revealing complex technical processes in securities trading. We can thus help companies, law enforcement agencies and prosecutors in understanding the complex interactions of a potentially wide network of internal and external, known and unknown participants (insider traders) and their actions. This research is of great significance to encourage enterprises to fulfill their social responsibilities and improve the supervision of illegal insider trading.

In order to analyze the implications of Pakistani statutes, similar laws as existing in the United States & China has been examined. Admittedly the capital markets of Pakistan and the United States cannot be compared. Nonetheless, reference to U.S. laws is appropriate for being long historical development through trial and error basis while comparing Pakistani statutes with other statutes, especially US, regarding insider trading would give an independent opinion as well and we could avoid such mistakes by learning from their experiences. To achieve this end, the pertinent documents like research work of US & Chinese researcher on the insider trading and transaction has also been examined to evaluate systemic problems to develop or enforce such enactments.

1.10 Research Methodology

A combined methodology of primary (through interactive and observational methods) and secondary sources (statistical, archival data and case-studies) has been used for insider trading studies in order to eliminate the limitation of each method. In order to attain aforementioned methodology, following tools have been utilized; *first,* Interactive Method by utilizing tools like Interview Data by putting up open ended questions to regulators, authors, lawyers, brokers, stock exchange officials & financial analysts. There was a challenge that any element of biasness in respondent might have resulted in distorted data to some extent. *Second,* Observational Method by participating & gaining entry in agency/institution/regulators which is difficult and limited degree of chances to avail information owing to suspicion and distrust by that agency or institution. *Third,* Analysis of Secondary Data by utilizing official statistical data relating to share price information which might result in more objective and quantifiable data of insider trading. *Fourth,* Analysis of Archival Data, i.e., written documents by utilizing historical record like government documents, court cases, administrative hearings and media reports because this has made me be able to compare easily the judicial process of different countries. Moreover, archival data is less expensive and more accessible than many other qualitative data. *Fifth,* is In-depth Case studies. These are more commonly adopted in studies of white-collar crime than in conventional crime research. Main advantage of case study is their in-depth and qualitative exploration of a particular event or persons while the challenge is that many of the conclusions are based on authors' personal views or speculations.

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Briefly, this study is comparative and analytical. Comparative in the sense that the enactments of various countries regarding insider trading were taken into consideration and compared the relevant provisions of such enactments with Securities Act, 2015. For this purpose, following tools

have been utilized, i.e., Enactments of all three regimes (bare Acts), commentary of writers on those enactments, various articles and books of authors. As far as enforcement, regulations and policies are concerned, this study is based on a dataset of sanctions imposed by regulators on individuals and companies for certain period in order to ascertain the effectiveness of the enactment to curb insider trading such as SECP in case of Pakistan. Moreover, case study method has been applied. For case studies, the judgments of all three regimes have been collected through reported cases in journals and subscription of law-sites. Further, the dataset has been compiled from publicly available data including: SECP Annual Market Data reports, websites, and case databases. Lists of matters prepared by the SECP have been relied on which are released annually and are available on the SECP's website. Moreover, meetings were conducted with key position holder of SECP for their input regarding lacunas in our insider trading enactments & enforcement inadequacies of regulators.

1.11 Literature Review

One of the first to investigate professional misbehavior, Edwin H. Sutherland, believed that as it raises questions, professional wrongdoing is more harmful to society than other types of wrongdoing.:

> *"The financial loss from white-collar crime, great as it is, is less important than the damage to social relations. White-collar crimes violate trust and therefore create distrust, which lowers social morale and produces social disorganization on a large scale. Other crimes produce relatively little effect on social institutions or social organization."*[96]

[96] E.R. Sutherland. "White-Collar Criminality (1940) 5 American Sociological Review at 4.

The fiduciary duty (or relationship of trust and confidence) concept used by the United States to outline the parameters of criminal insider trading and tipping has been rejected by other nations. The American strategy is flawed. The U.S. logic, for instance, focuses on the existence (or lack) of somewhat challenging questions to ascertain if the insider trading restriction applies in a particular circumstance: Is there a fiduciary relationship[97]? What is a fiduciary relationship or a relationship of trust and confidence[98]? Who qualifies as a quasi-insider and under what conditions[99]? " What evidence supports the wrongful use of the relevant information[100]? " At the moment of the trade(s), must a "insider" actually "use" the relevant information instead of just having it in their possession? What needs to be demonstrated to indicate that a tipper shared the relevant information for their own "personal benefit"? What is an "improper personal benefit"[101]? When the crooked executive knowingly trades on important inside information, for example, should he and his tip-offs be excluded from insider trading charges?[102] Should a family or acquaintance who unintentionally learns of material inside information while visiting the insider's home or business be allowed to lawfully trade on it?[103] On the basis of the distinction between a tender offer and a merger, should a person be entirely absolved or subject to criminal prosecution?[104] By adopting a concept akin to a fiduciary relationship (rejected by the SEC in the context of tender offers), the U.S. insider trading regulation adds to an already complicated issue, and sometimes rewards similarly situated market participants unjustly.

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[97] See Chiarella v. United States, 445 U.S. 222 (1980)
[98] See United States v. Chestman, 947 F.2d 551 (2d Cir. 1991)
[99] Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983).
[100] United States v. O'Hagan, 521 U.S. 642 (1997); Chestman, 947 F.2d at 551.
[101] SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984)
[102] Such conduct today is governed by Regulation FD
[103] Cf. Trib. Corr. Paris, 15 Oct. 1976, JCP 1977, 1 18543-D. 1978.381 (architect deemed insider due to his becoming privy to confidential information while visiting his client's office), discussed in Dominique Borde, France, in INsIDER TRADING IN WESTERN EUROPE: CURRENT STATUS 59, 65 (Gerard Wegen & Heinz-Dieter Assmann eds., 1994).
[104] e United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc)

Many other countries, as opposed to the United States, decide to forbid insider trading based on the "access" doctrine.[105] Those who have unequal access to the pertinent secret knowledge are normally prohibited from engaging in insider trading by this standard. This criterion may permit the extension of the restriction on insider trading to tippees who get the relevant information from traditional insiders or from other people who have access to it due to their occupation, office, or line of business. This broad concept is followed by numerous nations, including the UK,[106] France,[107] Germany,[108] Italy,[109] Canada (Ontario),[110] and Mexico.

Thus, it would be expected that fewer countries would choose for a more comprehensive strategy based on the parity of information notion.[111] For instance, Australia's law on insider trading generally applies to anyone or any business that holds nonpublic, price-sensitive information.[112] In Australia, if you "(a) possess[e] information that is not generally available but, if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of securities of a body corporate; and (b).... knowing, or ought reasonably knowing, If the information is not generally available; and (ii) that you are an insider, you are subject to the insider trading and tipping prohibitions."[113]

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[105] EC Directive on Insider Trading,

[106] Criminal Justice Act §§ 52, 57 (1994);

[107] Hence, under Regulation 90-08, the following are defined as insiders: (a) [Plersons holding privileged information by reason of their capacity as members of management, board of directors of an issuer, or by reason of their functions which they exercise with respect to an issuer; (b) [plersons holding privileged information by reason of the planning and execution of a financial operation: (c) [plersons to whom privileged information is disclosed during the exercise of their professional activities or functions; and (d) [p]ersons who, with full knowledge of the facts, possess privileged information originating directly or indirectly from [any of the foregoing insiders].

[108] Securities Act § 13(1)

[109] Consolidated Act on Financial Intermediation, art. 180, para. 3.

[110] Ontario Securities Act, ch. S-5, § 76(5) (1990) (Can.).

[111] SEC v. Texas Gulf Sulfur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc)

[112] Corporations Law § 1002G (Austl.).

[113] STEINBERG, supra note 88, at 142.

In regards to "tipping," just as it has been in regards to the accountability of insiders and access individuals for trading, the American standard has been rejected abroad.[114] Australia, for example, takes an expansive attitude and outlaws any tipper (no matter how far away) who is aware of crucial inside information from utilising or tipping it.[115] Similar to the US, the UK forbids trading and tipping for anyone who knowingly obtained material private information from an insider, either directly or indirectly. Many other nations use approaches that are perhaps less comprehensive than the American standard, though they are less complex. For example, important insiders are prohibited from both trading and tipping under German law, but people who get materially sensitive information from a key insider are allowed to share the information with others.[116] Comparable standards have been adopted by Japan,[117] France,[118] and Italy.[119]

Any accusation of insider trading must have material nonpublic information as a prerequisite. Generally speaking, a claim of insider trading cannot be based on knowledge that is "public". This includes knowledge that has been made available to the general public as well as information that an investor has independently developed based on personal observation of the general public. A charge of insider trading cannot be made, for instance, based on observing trucks leaving a warehouse on a public road to gauge the degree of demand for a product. The information in question must also be "material" in order to sufficiently state a cause of action for insider trading. Information is considered material by the Supreme Court of the United States if "there is a substantial likelihood that a reasonable shareholder would consider it important" when making an

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[114] Corporations Law § 1002E (Ausd.).
[115] Criminal Justice Act §§ 52, 57 (1994).
[116] Securities Act § 14(1)-(2).
[117] Law No. 90-08, arts. 2-5, J.O., July 20, 1990; art. 10-1 of Ordinance No. 67-833. See Borde, supra note 120, at 66-69.
[118] Consolidated Act on Financial Intermediation No. 58, art. 180, paras. 1, 2, discussed in STEINBERG, supra note 88, at 132-33.
[119] Securities and Exchange Law art. 166, paras. 1, 3.

investment decision.[120] According to this requirement, it must be demonstrated that there is a strong chance that the fact "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.[121] In an insider trading case involving an institutional investor, the question of whether certain information is relevant frequently becomes the focal point. Regardless of whether the information gained was nonpublic, in general, an investor who compiles many non-material pieces of information to arrive at a material conclusion has not broken the law against insider trading.[122] In fact, institutional investors like hedge funds frequently piece together bits of non-material information that is both public and non-public in order to comprehend the overall situation of a specific company. This practise, also known as the "mosaic" theory of investing, can be used as the foundation for a defence against accusations of insider trading, especially when the SEC alleges that an investor traded on information that he or she may have unintentionally learned from a tipper who violated his fiduciary duty.[123]

Countries like Japan, Hong Kong and China, New Zealand's insider trading law utilizes a person connection approach in its meaning of "insider" therefore, in New Zealand, The Securities Markets Act, 1988 adopts a “person connection” approach in defining “insider”, whereby an insider is defined to include anyone who holds material price-sensitive information that is not generally

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[120] , Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (articulating materiality standard in shareholder voting context); Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (expressly adopting the standard of materiality from TSC Industries, 426 U.S. 438 (1976), for the context of Rule 10b-5).

[121] TSC Indus., 426 U.S. at 449.

[122] To be sure, if all the non-material information was obtained through improper means (i.e., with knowledge of the breach of a duty to the source of the information), a court may view the information in the aggregate as a “material” whole and thus hold that the conduct constitutes insider trading, assuming all of the other elements are met. This may be particularly true when all of the improperly obtained non-material nonpublic information derives from a single source.

[123] State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 854 (2d Cir. 1981) (citation omitted); see also Andrew Ross Sorkin, Collecting Tidbits, and Trouble, N.Y. TIMES, Nov. 30, 2010, at B1 (discussing mosaic theory as a defense employed by Raj Rajaratnam, founder of the Galleon Group).

available, and who has certain relationships with the public issuer[124]. It is pertinent to mention that New Zealand has changed its approach from person connection to information connection in 2006.

As George Soros' situation in France demonstrates, other developed markets are sensitising to a greater extent.[125] As foreign regulators work to increase local investors' confidence and draw in the international investment community, the relevance of monitoring insider trading has taken on a global dimension.

As far as United Kingdom and Australia are concerned, they have to adopt their definitions to mirror the information connection approach while defining insider. The United States, in spite of the fact that the principal nation to address the issue of insider trading, does not have a statutory meaning of "insider" and rather depends on by and large pertinent laws against securities enactments. It has embraced a "person-connection" approach in characterizing "insider", whereby an insider is characterized to incorporate any individual who holds material value touchy information that isn't for the most part accessible, and who has certain associations with the general population issuer. This might be stood out from the "information-connection" approach, under which any individual who has material value touchy information that isn't for the most part accessible is viewed as an insider, paying little mind to his or her relationship to the person holding the information.[126]

Laws handling the insider trading in USA have been in power for various years, and insider trading has been depicted as: *"The representative white-collar crime of the 1980s"*[127] The US was the

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[124] Section 3(1), The Securities Markets Act 1988, New Zealand

[125] See Jo Wrighton, SorosAwaits Verdict In Case in France On Insider Trading,WALL ST. J., Dec. 2, 2002,

[126] Reform of Securities Trading Law: Volume One: Insider Trading: Fundamental Review. Discussion Document, Ministry of Economic Development (May 2002) [109].

[127] Elizabeth Szockyj, The Law and Insider Trading: In Search of A Level Playing Field (1993) 1.

main country to effectively manage insider trading. The use of the term "insider" in various contexts is partially reflected in and influenced by the US legislation of insider trading.[128] Only a few states have adopted the US approach to dealing with the law in this area, but the fact that the US has an insider trading statute and has taken, since the mid-1960s, a truly aggressive stance in enforcing it has influenced most other countries to enact insider trading laws. This is particularly true in terms of New Zealand legislation. Therefore, it is proposed that the prohibitions against insider trading, tipping, and tippee trading in New Zealand bear a striking likeness to those in America. Therefore, the American experience can be used as a helpful point of reference for any potential conflicts that may arise while regulating these types of violations.[129]

In addition to less stringently enforcing the law, the target nation frequently exhibits cultural attitudes that support insider trading. [130] The securities market and the way that business connections have been maintained for many years, if not centuries, have historically been considered by affected parties as being incorporated with such behaviors.[131] Authorities may find it more challenging to take enforcement action against allegedly respectable business executives as a result of this mentality. Because many countries do not considerably authorize civil enforcement by either the government or allegedly aggrieved private persons,[132] this reluctance

[128]Michael Ashe and Lynne Counsell, Insider Trading (2nd ed, 1993) 27.

[129] James D. Cox, 'An Economic Perspective of Insider Trading Regulation and Enforcement In New Zealand' (1990) 4 Canterbury Law Review 268, 277

[130] For example, although having a relatively detailed insider trading proscription, South Africa has initiated few, if any, criminal prosecutions. See Zyl, South Aftica Insider Trading Regulation and Enforcement, 15 Comp. LAW. No. 3, at 92 (1994). Although viewed as doing more to combat insider trading than most jurisdictions, "prosecution of insider trading [in Canada] remains minimal." Ramzi Nasser, The Morality of Insider Trading in the United States andAbroad, 52 OKLA. L. REv. 377, 385 (1999). With respect tojapan, that country is perceived as an "'insider's heaven' where people rampantly profit from inside information with little detection or prosecution." Id. at 382, quoting Tomoko Akashi, Regulation of Insider Trading in Japan, 89 COLUM. L. REv. 1296, 1302 n.45 (1989).

[131] Andre Tunc, A French Lawyer Looks at American Corporation Laws and Securities Regulation, 130 U. PA. L. REV. 757, 762 (1982) (stating that in France tipping of material nonpublic information is perceived as "a social duty ... expected of relatives and friends"); sources cited supra note 144. But see Wrighton, .rupra note 6

[132] STEINBERG, supra note 88, at 148 (Japan); Nasser, supra note 158, at 380-84; George F. Parker, The Regulation of Insider Trading in Japan: Introducing a Private Right ofAction, 73 WASH. U. L.Q. 1399 (1995).

may be made worse by the primary reliance on a criminal mode of enforcement. 'In a society that does not often recognize the wrongs of such "gentlemen" conduct, it is unlikely that "admired" executives would be charged with crimes.[133] Courts are important in this process as well since they regularly decline to convict a "insider" based merely on circumstantial evidence and only impose light punishments when guilt has been proven.[134] There is still a long way to go before insider trading enforcement is as effective as it is in the United States,[135] despite recent occurrences in some countries suggesting that additional surveillance and enforcement tactics are being employed.[136] As a result, despite some "loopholes," American insider trading law remains the most significant.[137]

The SEC's vital role as regulator is made possible by its qualified employees, enough of resources, and efficient oversight, which help in the active enforcement of the US securities laws.[138] Criminal prosecution for insider trading is becoming a recognized component of the enforcement landscape. [139] As a supplementary measure of enforcement, under certain circumstances, purportedly harmed traders may launch civil claims for damages against those who violated the insider trading regulations.[140]

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[133] STEINBERG, supra note 88, at 264.
[134] Tomasic & Pentony, The Prosecution of Insider Trading: Obstacles to Enforcement, 22 AUST. & N.Z. CRIMIN. 65, 65-66 (1989); McDonald, Australia, in INTERNATIONAL INSIDER DEAlING 439, 442 (Mark Stamp & Carson Welsh eds., 1996).
[135] In Germany, the first conviction for insider trading was not procured until 1995; moreover, no prison sentence was ordered. See Commerzbank Declines to Comment on Report of Insider-Trading Case, WMAL ST.J., Aug. 22, 1995, at A6. See also Ex-Laoyer Gets Suspended Term for Insider Trading, JAPANs WEEKLY MONITOR, Aug. 4, 1997.
[136] STEINBERG, supra note 88, at 121-40, 214-37; Wrighton, supra note 6.
[137] New Curbs on Insider Trading, Market Abuse Agreed to by EU Parliament, 34 Sec. Reg. & L. Rep. (BNA) 432, 433 (2002) (stating that from 1995 through 2000, there were "only 13 successful prosecutions leading to criminal penalties across the 17 nations of [the] European Union and its neighbors in the European Economic Area"); Nasser, supra note 158, at 377 (stating that in addition to Canada andJapan, "insider trading seems to go largely unpunished in Australia, France, Germany, and Mexico").
[138] DAVID A. VISE & STEVE COLL, EAGLE ON THE STREET (1991).
[139] Securities Exchange Act § 32(a); United States v. O'Hagan, 521 U.S. 642 (1997).
[140] Securities Exchange Act §§ 10(b), 20A, Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980)

CSR is a crucial channel via which businesses can provide non-financial data and have an impact on the occurrence of insider trading.[141] However, recent research examined the correlation between CSR and insider trading by taking into account a sample of China's Shanghai and Shenzhen A-share listed companies from 2011 to 2016.[142] The findings are as follows. (1) There is a sizable inverse relationship between CSR and insider trading. (2) The CSR of non-state-owned businesses can greatly reduce the incidence of insider trading, however the relationship is insignificant for state-owned businesses from the standpoint of the nature of the business. (3) Voluntary disclosure can greatly reduce the incidence of insider trading from the standpoint of disclosure motive. Mandatory and semi-mandatory disclosure, however, are not important. The research presented in this study is very important for motivating businesses to uphold their social obligations and for enhancing the oversight of unlawful insider trading. In general, businesses with good CSR scores do not actively pursue immoral or unethical insider trading.[143]

Regarding the effects of the law on insider trading in Pakistan, the SECP has produced a number of highly valued works to outline the installations of an effective administrative body to oversee and direct the capital markets in Pakistan. The SECP, which was established in 1999 as a commission to replace the former CLA, has undertaken some bold initiatives and daring steps to put the capital markets in a powerful order, particularly to protect the privileges and premiums of small financial experts and minority investors.[144] Inside trading has long been a problem for exchanges and smaller financial firms, and the legislature has called for effective regulation of this

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[141] A company's duty to pursue long-term objectives is known as corporate social responsibility (CSR), and it is a crucial component of a sustainable society. It has to do with the public's expectations as well as the company's ability to survive and grow sustainably.

[142] Lu, Chao, Xuetong Zhao, and Jingwen Dai. 2018. "Corporate Social Responsibility and Insider Trading: Evidence from China" Sustainability 10, no. 9: 3163. https://doi.org/10.3390/su10093163 last accessed March 23, 2022

[143] Ibid.,

[144] Securities Act (2015), Part II, available at http://www.secp.gov.pk/laws/acts/ last accessed May 15, 2020

unethical economic practice. The 2015 Securities Act seeks to simplify the interwoven legal framework and eliminate the deficiencies and gaps in the 1969 Securities Exchange Act. It provides a thorough administrative framework that includes plans for approving eligibility requirements for granting permission to all market representatives, including stock trades, the clearing organization, the focal safe organization, stock specialists, operators of stock dealers, financiers, balloters, exchange specialists, and others.[145]

Without a doubt, SECP is acting in two key capacities: first as a regulator, and second as a market creator or enabler. The SECP should promote the growth of capital markets, match savings with possible investment opportunities, and make sure that they are effectively regulated and that the interests of all parties involved are protected.[146] To ensure that the markets are "fair, transparent, and have adequate liquidity," its function as a "champion for the market" must be carefully balanced against its role as a regulator. Some significant issues that the regulator had to address included market liquidity, adequate public disclosure of key information, and badla financing.[147] Since its formation, the SECP has been dealing with these concerns without any regulations. However, there are still problems, such as the lack of incentives for saving to go into the capital markets, the reliance on risky types of leverage trading, the poorly designed margin financing system, the insufficient supply of liquidity, and the failure to create new and creative market instruments.

After going through the available literature in US, China & Pakistan regarding Insider, it has been revealed that there are certain grey areas which need immediate attention starting from definition clause to enforcement mechanism to court rulings. A report from the Asian Development Bank

[145] ibid

[146] Recorder Report, SEO 1969 should be replaced with Securities Bill 2015, Business Recorder, Jan 30, 2015

[147] Hassan, Dr.Tariq, "Badla is not back", https://www.secp.gov.pk/wp-content/uploads/2016/05/july_22_Badla.pdf last accessed March 27, 2022

asserts that "Insider trading is common and front running is still prevalent.[148] Most significant reason is that definitions in the available bare acts comes in conflict and contradicts with each other. Moreover, Pakistani courts have not bothered to utilized the development of common law of US through its theories. Moreover, rules framed by SEC in US has not specifically outlaw the Insider Trading, rather, it talks about use of manipulative and deceptive devices while trading on securities. If we talk about risk management system in Pakistan with a proper structure, we don't find it Pakistan stock exchanges. However, the new Securities Law was quite simple in order to successfully manage the commission. Regarding the insider trading incidents, the SECP has taken action in 40 of them at stock exchanges. The Act lists provisions governing Securities Exchanges, clearing houses, central safes, authorizing necessity, qualification, obligations, control making powers, endorsement of directions, disciplinary activity, activity survey, crisis forces of the Commission, suspension or retraction of permit, records and review, unique review, yearly reports, etc.[149]

According to a 2004 International Monetary Fund assessment, "SECP should review the rules about insider trading to ensure that they can be effectively enforced in particular cases."[150] The SECP has started the review of legal provisions pertaining to insider trading and security disclosure but progress has not been seen so far.[151] It is, therefore, inevitable to shed light on grey areas of Insider Trading regulatory framework in order to curb it with plausible recommendations.

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[148] Asian Development Bank, , TAR: PAK 35055, technical Assistance to the Islamic Republic of Pakistan for Capacity Building for Capital market Development and corporate Governance (August 2001), 1.
[149] Ibid.
[150] International Monetary Fund, IMF Country Report No. 04/215 Pakistan: Financial System Stability Assessment, Including Reports on the Observance of Standards and Codes on the Following topics: Monetary and Financial Policy Transparency , Banking Supervision, and Securities Regulation (July 2004), 42. "In addition, the assessors have queried whether insider trading law is adequate to deal with those who benefit from insider trading but are not insiders as defined, in particular, tippees of insiders. " Ibid. 39.
[151] Ibid. 45

1.12 Conclusion

The term "insider trading" is a misnomer, as many observers have pointed out. For instance, the group of people who are typically regarded as "insiders" have not been exempt from penalties for insider trading. Since its inception; insider trading has not only been a well-known practice around the world in most of the capital markets but at the same time a significant area for discussion to the researchers, academia, policymaker, practitioners, and decision-makers. Further, there should not be any doubt that it not only influences the market efficiency but also the transparency of the markets' operation.

In this Chapter, it was attempted to recognize diverse ways insider trading happens in securities exchange. It has not been to make a case for or against more vigorous enforcement/regulation of insider trading laws in Pakistan. It is, however, submitted that this issue needs to be debated. We must consider whether in light of the condition prevailing in our capital markets, regulations prohibiting insider trading laws are desirable and enforceable in practice. Clarifications and amendments to the insider trading laws are required not only to strike this balance but also to avoid loss and expenses that investors may suffer due to litigation that may emerge as Pakistan's capital markets become more sophisticated but are yet dictated by rather obscure and vague statutes.

CHAPTER TWO

CONFLICT BETWEEN COMMON LAW & STATUTORY LAW; LEADING TO DEVELOPMENT OF INSIDER TRADING THEORIES

2.1 Introduction

Essentially, in US two inconsistent laws of Insider Trading simultaneously at war with one another. One is the law promulgated by Congress & SEC while second is common law developed by US supreme court which SEC dislike. Evidently, Insider Trading in US relied on custom based(common) law prior to legislation by congress. Before 1905, Under the common law, majority SH ruling was in place i.e., corporate officers historically didn't have a duty to disclose material facts to shareholders when engaging in private trading of the company's stock. But, in Strong v. Repide (1909), "special circumstances theory" was developed which relied on minority SH rule which emphasized that there is need to disclose price sensitive information to minority SH. In Strong versus Repide, the United States Supreme Court considered whether any circumstances exist under which the common law imposes a duty of disclosure on corporate officers engaged in private trading.[152]

Indeed, the United States has historically been the world leader in insider trading law. It is an interesting fact that 1929 great depression led to the promulgation of Securites Act 1933 & Securities Exchange Act, 1934 and the most important clause which were put forwarded by SEC in court against the accused was Section 10b dealing with use of deceptive or manipulative device to gain advantage and Section 16 relating to short swing profit gained during the last six months. However, these acts didn't explicitly outlaw Insider Trading. But, in 1961, in a matter of Cady,

[152] Strong v. Repide 213 U.S. 419 (1909)

Robert & Co. (Disclosure or Abstain Rule) was developed which says that directors of company are dutybound to either disclose the material price sensitive information related to securities or abstain from trading on such securities.[153] The same was reiterated in 1963 in SEC v. Texas Gulf Sulphur where court has developed "Parity of Information Rule" which means everyone has Equal Access to price sensitive Information related to securities.[154] Series of theories developed by common law from 1980 to 2009 of which classical theory, tipping theory, misappropriation theory (unified theory), and mosaic theory are significant. These theories showed that common law has remained at logger heads with SEC's rules/regulations and enactments passed by the congress which will be critically analyzed in this chapter. Moreover, Pakistani case laws will also be discussed, but in next chapter. Furthermore, these theories will be analysed in Pakistani perspective in next chapter.

2.2 Prevailing Legal Theories of Insider Trading Liability

Criminals can now steal financial information from global corporations.[155] By trading on confidential information that they have obtained, these hackers can negatively impact financial markets. However, insider trading has received a lot of attention in securities law, which has not addressed the responsibility of "mere thieves"[156] who use illegal means to acquire confidential financial information to trade on.[157] As a result, there is a gap in the securities law about how to

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[153] In re Cady, Roberts & Co. 1963

[154] See S.E.C. v. Texas Gulf Sulphur, 401 F.2d 833, 885 (2 Cir. 1968)

[155] See, e.g., Litigation Release No. 19,450, U.S. Securities and Exchange Commission, SEC Files Emergency Action Against Estonian Traders to Stop Ongoing Fraudulent Hacking Scheme (Nov. 1, 2005), http://www.sec.gov/litigation/litreleases/lr19450.htm; see also SEC v. Lohmus Haavel & Viisemann, No. 05-CV-9259 (S.D.N.Y. May 30, 2007) (final judgment against hackers)

[156] David C. Bayne, Insider Trading: The Misappropriation Theory Ignored: Ginsburg's O'Hagan, 53 U. MIAMI L. REV. 1, 64 (1998).

[157] See, e.g., Chiarella v. United States, 445 U.S. 222, 239–40 (1980) (Burger, C.J., dissenting) (arguing that insider trading rules should apply to "any person engaged in any fraudulent scheme," not just parties with some fiduciary relationship); see also Bayne, supra note 2, at 64 (distinguishing "[m]ere" thieves from "[t]rusted" thieves); Donna M. Nagy, Re- framing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion, 59 OHIO ST. L.J. 1223, 1255 (1998) (deeming it "doubtful" that a hacker's or thief's securities trades would violate Rule 10b-

handle the theft and use of private financial information by strangers under SEC Rule 10b-5.[158] Although the federal securities laws do not expressly proscribe insider trading, Section 10(b) of the Securities Exchange Act of 1934 [159] and Rule 10b-5 [160] promulgated thereunder by the Securities and Exchange Commission ("SEC") have been interpreted as prohibiting insider trading.[161] In interpreting these provisions, the SEC and the federal courts have developed several

5); Rebecca S. Smith, Comment, O'Hagan Revisited: Should a Fiduciary Duty Be Required Under the Misappropriation Theory?, 22 GA. ST. U. L. REV. 1005, 1014 (2006) (describing the criticisms of O'Hagan's fiduciary duty requirement, stating that the use of nonpublic information, not the manner in which it is acquired, is "at the heart" of the harm).

[158] A stranger's theft of confidential financial information may be a consequence of computer hacking or of more traditional misconduct such as burglary or robbery. But even if the theft is a consequence of computer hacking, many commentators believe that Section 10(b) and Rule 10b-5 probably do not cover misconduct by a "'mere' thief." See, e.g., Nagy, supra note 3, at 1255. This is despite the SEC's creation of an Internet enforce- ment division that investigates and prosecutes Internet securities-related fraud. See Internet Enforcement Program, http://www.sec.gov/divisions/enforce/internetenforce.htm (last visited Apr. 4, 2020) (describing the SEC Office of Internet Enforcement and its mandates)

[159] Section 10(b) provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange-... (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[160] Rule 10b-5 provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

[161] The original purpose of section 10(b) was not necessarily to prohibit insider trading. See Elizabeth Szociyj, The Law And Insider Trading: In Search Of A Level Playing Field 5 (1993) ("Contrary to popular belief, Section 10(b) ... which today is the most commonly used section to prosecute insider trading, was not originally designed to serve this purpose."); id. at 6 ("Nowhere in the legislation or in related discussions at the time is there an implication that Section 10(b) should be interpreted to include or could be applied against insider trading."). For a comprehensive discussion of the original purpose of section 10(b), see Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act, 42 STAN. L. REV. 385 (1990). Nor was the central purpose of Rule 10b-5 to prohibit insider trading; indeed, the rule was initially drafted to prevent insiders from making fraudulent statements to shareholders about the corporation so that they could buy shares more cheaply. See Milton Freeman, Discussion at the Conference on Codification of the Federal Securities Laws (Nov. 18-19, 1966), in 22 Bus. LAw. 793, 922-23 (1967) (discussing the adoption of Rule 10b-5). In 1943, Milton Freeman, an SEC attorney, received news about a company president who was buying up shares of stock of his own company, simultaneously telling shareholders that the company was faltering, though in fact the prospects of the company were extremely favorable. See id. at 922 (describing a phone call in which Freeman learned that "'the president of some company... is... buying up the stock of his company... and... telling [shareholders] that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled'"). Attempting to address this problem, Freeman drafted Rule 10b-5. See id. (explaining that Rule 10b-5 "was intended to give the Commission power to deal with this problem"). Section 16(b), 15 U.S.C. § 78p(b) (1994), is the only provision that expressly proscribes trading by insiders. See, e.g., FERRARA ET AL, supra note 6, § 1.02(11) [a], at 1-3 ("The only provision of the securities statutes that expressly regulates insider trading is Section 16(b) of the Exchange Act, which prohibits 'short swing' profits by officers, directors, and the direct or indirect beneficial owners

theories and the same have been adopted by other corporate regime in the world according to their need and suitability. Theories have been developed from Parity of Information to breach of Fiduciary duty to misappropriation and extended misappropriation.[162] These are illustrated as under;

2.2.1 'Parity of Information' Theory

"Parity-of-information" theory, Or Equal Access to Information Theory is the foundation of the prohibition against insider trading.[163] The Securities Exchange Act's Section 10(b) and rule 10b-5, which ban insider trading, were evolved through an un-organised and occasionally inconsistent series of court decisions, laws, and SEC rules. The current limitation can only be adequately understood in the context of its historical background because of this. As a result, we shall take a historical approach to investigate the relevant laws. It was started first when in 1942 the S.E.C. enacted Rule 10b-5[164] under Exchange Act section 10(b), it did not explicitly address insider

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of more than 10% of any class of equity securities." (footnote omitted)). "Short-swing" trading refers to "any purchase and sale, or any sale and purchase" within a period of less than six months. 15 U.S.C. § 78p(b). Many have asserted that section 16 was designed to prevent insider trading. See 15 U.S.C. § 78p(b) (explaining that the purpose of the provision is to "prevent[ ] the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer"). But section 16 imposes liability on insiders who engage in short-swing trading, regardless of whether they were in possession of material, nonpublic information at the time of the trades. And insiders can avoid liability under section 16(b)-even if they are trading while in possession of material, nonpublic information-as long as they do not enter into offsetting transactions within a period of less than six months (i.e., a sale following a purchase or a purchase following a sale). Some commentators have thus proposed alternative explanations of the purpose of section 16(b). SeeKarl Shumpei Okamoto, Rereading Seclion 16(b) of the Securities Exchange Act, 27 GA. L. REv. 183, 185 (1992) ("The purpose of Section 16(b) is not the deterrence of trading on non-public information.... Its purpose is to deter insiders from trading to artificially affect market prices-to deter insiders from sending false signals when in fact there is no inside information at all."); Steve Thel, The Genius of Section 16: Regulating the Management of Publicly Held Companies, 42 HASTINGS LJ. 393, 453 (1991) (asserting that the purpose of section 16 was to prevent the manipulation of corporate opportunities).

[162] Bondi, Bradley Joseph and Lofchie, Steven D., The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance (March 24, 2012). New York University Journal of Law and Business, Vol. 8, p. 151, 2012, Available at SSRN: https://ssrn.com/abstract=2028459

[163] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), 2003 O.J. (L 96) 16 [hereinafter Market Abuse Directive]. 7 See In the matter of Cady, Roberts & Co., 40 S.E.C. 907 (1961).

[164] unlawful, for any person in connection with the purchase or sale of a security: "(a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made . . . not misleading, or (c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit on any person."

trading; the rule, in fact, does not even contain a reference to this type of conduct, but is a broad and general antifraud provision.[165]

2.2.1.1 Introduction of "Disclose or Abstain" concept In re Cady, Robert & Co.

The history of the rule's introduction demonstrates that the S.E.C. did not take insider trading into account when it enacted the provision.[166] In re Cady, Roberts & Co.,of 1961, an administrative proceeding, the Commission only began applying rule 10b-5 to penalise insider trading that took place on impersonal markets in the 1960s.[167] The concept of "disclose or abstain" was first used by the Commission in this situation, and it was founded on the idea of equal access to information, according to which trading on the basis of significant, non-public information violated Rule 10b-5.[168]

According to Bainbridge, Cady's precedential relevance was questionable because it included an administrative process and a financial intermediary operating in a strictly regulated sector.[169] But a few years later, in 1963, in S.E.C. v. Texas Gulf Sulphur, the Second Circuit accepted the idea of equitable access to information.[170] The facts of this case, like many previous insider trading

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[165] 17 CFR §240.10b-5 (1996).

[166] See S.E.C. v. Texas Gulf Sulphur, 401 F.2d 833, 885 (2 Cir. 1968)

[167] 40 S.E.C. 907 (1961). As noted by Roberta S. Karmel, Outsider Trading on Confidential Information – A Breach in Search of a Duty, 20 CARDOZO L. REV. 83 at 87, at common law insider trading on a stock exchange was not considered unlawful because directors were considered to only have a fiduciary duty to the corporation, not individual shareholders. Only non-disclosure of inside information in a face-to-face transaction could be considered illegal. In this case the director of a registered corporation, J. Cheever Cowdin, was also a partner of Cady, Roberts & Co., a stock brokerage firm. In his capacity as director, Cowdin learned that the corporation was about to reduce its dividend, and shared this information with Robert M. Gintel, another partner of the brokerage firm. Gintel sold his clients' shares of the corporation before the dividend cut was announced, thus avoiding significant losses they might have otherwise suffered. The S.E.C. sanctioned Cady, Roberts & Co., arguing that a violation of Rule 10b-5 had occurred because Gintel traded while in possession of material, non-public information.

[168] Ibid at 911

[169] Stephen Bainbridge, An Overview Of Insider Trading Law And Policy: An Introduction To The Insider Trading Research Handbook 5 (Edward Elgar Publishing Ltd., 2013) available at http://ssrn.com/abstract=2141457; see also e.g., Recent Decision, 48 VA. L. REV. 398, 403-04 (1962) ("in view of the limited resources of the Commission, the unfortunate existence of more positive and reprehensible forms of fraud, and the inherent problems concerning proof and evidence adhering to any controversy involving a breach of duty of disclosure, there is little prospect of excessive litigation evolving pursuant to [Cady, Roberts]".

[170] 401 F.2d 833 (2nd Cir. 1968).

lawsuits, remind one of a fictional story. In other words, Texas Gulf Sulphur started looking into the possibility of precious minerals in an area of Ontario in secret in 1959.[171] Employees of the company who participated in the surveys were specifically instructed to keep any knowledge about the potential discovery private.[172] Surveys revealed an abundant ore deposit, and the company began buying up land where the minerals might be exploited.[173] Employees of Texas Gulf Sulphur started purchasing the company's stock or stock options in 1963 while the knowledge remained a secret, and they also informed third parties about the potential for share price gain.[174] In reality, the price of the shares shot up as word of the finding spread, giving employees and their tippees a sizable profit.[175] The SEC filed a lawsuit against the insiders, saying that Rule 10b-5 had been broken. [176] The Second Circuit court agreed with the S.E.C.'s stance, ruling that an insider who had important, non-public knowledge was required to either reveal the information to the public or refrain from trading in the stock.[177] The notion of equal access to information, which holds that all investors should have access to the same information when trading and that insiders cannot profit from unshared information, served as the basis for this ruling.[178]

2.2.1.2 Failure of 'Parity of Information theory' due to 'expansive/broad approach'

This broad definition of insider trading sent tremors through the legal and financial communities. It was feared that using such a broad approach would provide unfair outcomes and impede the growth of active markets. When the Supreme Court revisited the matter seven years later in the landmark case of Chiarella v. U.S., the court disregarded the equality of access to information

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[171] Ibid at 843
[172] Ibid at 843
[173] Ibid at 844
[174] Ibid at 843-45
[175] Ibid at 847
[176] Ibid at 848
[177] ibid
[178] Ibid at 849

strategy and limited its potentially wide-ranging application.[179] To be able to do this, the Court insisted that additional elements be present in order to establish insider trading culpability i.e., breach of the insider's fiduciary duty to the investors he dealt with rather than merely accepting that the mere possession of substantial, non-public information imposed the obligation to disclose or refrain.[180]

2.2.2 The Classical Theory Or 'Breach of Fiduciary Duty' Theory

The classical theory of insider trading is a form of insider trading where a corporate insider, i.e. an employee, director, or officer commits securities fraud [181] by trading in securities of their company on the basis of material non-public information.[182] Under the Classical Theory of insider trading, a person in possession of material, non-public information has a duty to abstain from trading, or disclose the information before trading, if such person has a fiduciary relationship with the shareholders. As a result, the Classical theory normally is available only with respect to directors, executive officers and controlling shareholders of a corporation.[183]

The outlines of the Classical theory were laid down by the United States Supreme Court in Chiarella v. United States[184] in 1980. Chiarella worked for a printing business that produced takeover-related documentation. He was able to determine the true identities of the firms and profit by buying stock in them before the public announcement of the takeovers, despite the fact that there were processes in place to protect the secrecy of the companies to the transactions.

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[179] 445 U.S. 222 (1980).

[180] Id. at 224-35.

[181] Securities fraud is the misrepresentation or omission of information to induce investors into trading securities. https://www.law.cornell.edu/wex/securities_fraud Last accessed June 10, 2021

[182] https://www.law.cornell.edu/wex/classical_theory_of_insider_trading. Last accessed June 10, 2021

[183] Thomas E. Geyer Insider Trading: Evolution, Prevailing Theories and Recent Developments, 5.

[184] Chiarella v. United States, 445 U.S. 222 (1980).

In examining Chiarella's failure to disclose before trading, the court started with the proposition that "silence could create liability for fraud only where there was a duty to disclose."[185] This led the Court to reject the Texas Gulf Sulphur" "Parity of Information rule" which holds that the mere possession of material, non-public information required a person to abstain or disclose. Instead, the court held that "there must be a relationship of special trust and confidence (such as a fiduciary relationship) between the possessor of material, non-public information and the shareholders in order for the possessor to have a duty to abstain or disclose." [186] The court acknowledged that corporate officers and directors have such a fiduciary relationship, but Chiarella was not a corporate officer or director. Accordingly, he was not otherwise in a relationship of special trust and confidence and was not required to abstain or disclose before trading. [187]

2.2.2.1 Liability for Insider Trading

In virtually the identical sentence that it used to develop the traditional approach in the first place, the Supreme Court made it clear that insider trading culpability includes trading in impersonal marketplaces. In actuality, the Chiarella case itself made this holding implicit. Even though Vincent Chiarella purchased the takeover targets' stock on national securities exchanges, Justice Powell's majority opinion did not overturn Chiarella's conviction under Rule 10b-5 for this reason.[188] Chiarella, on the other hand, was exempt from liability since he had no fiduciary

[185] Thomas E. Geyer Insider Trading: Evolution, Prevailing Theories and Recent Developments, 3.
[186] Ibid. The Court said: "We hold that a duty to disclose under Sec.10(b) does not arise from the mere possession of nonpublic market information. 445 U.S. 234.In other words, there can be no Sec 10(b) violation absent a duty to disclose. In so holding, the Court rejected the argument that a person violates Sec. 10(b) simply because he has trades in a security with respect at which he has an informational advantage.
[187] The case abstract records the holding as follows: "A duty to disclose in formation arises if there is a relationship of trust and confidence between parties to the transacting. Chiarella had no such duty. He was not a corporate insider in the acquiring corporation and he did not receive confidential information from the target company. He also had no fiduciary relationship with the shareholders of the target company: he was not their agent; they placed no trust or confidence in him; indeed, they had no prior dealings with him. A duty to disclose under Section 10(b) does not arise from the mere possession of nonpublic market information." Chiarella v. United States, 445 U.S. 222 (1980), docket Number: 78-1202, Abstract (available at http://www.oyez.org/oyez/resource/case/877/(last visited Dec 1, 2020)
[188] Chiarella v. United States, 445 U.S. 222, 237 (1980).

obligation to the counterparties of the transaction because he was not an insider.[189] Regarding the question of exchange-based insider trading, the Court made it plain that it did not matter whether the transaction took place face-to-face or virtually, and that the common law of fraudulent non-disclosure applied to both types of transactions.[190] But on this point, the Supreme Court was flat-out mistaken. True, corporate executives have a responsibility of disclosure to shareholder counterparties under common law when engaging in face-to-face trading.[191]

This was an exception to the usual rule that insiders are not generally obligated to make such disclosures, and the rationale for this can be attributed to the widely held belief among state courts that insiders' fiduciary duties are owed to the corporate entity rather than to the individual shareholders. [192] Therefore, under common law, corporate insiders who transacted with

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[189] See id. at 231-35.

[190] See id at 227-28 ("At common law, misrepresentation made for the purpose of inducing reliance upon the false statement is fraudulent. But one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information "that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.").

[191] In reality, there were two approaches at common law to a corporate insider's disclosure duties when transacting with shareholders. There was the simple rule that corporate insiders did in fact owe such duties. There was also the special facts doctrine, which held that corporate insiders owed such duties only when there were special facts at play, for example, if the insider attempted to conceal his identity from the shareholder. However, both of these rules only applied to face-to-face transactions, not impersonal transactions over exchanges. See Barbara A. Ash, State Regulation of Insider Trading--A Timely Resurgence?, 49 OHIO ST. L.J. 393, 399-400 (1988) ("[L]ong before even the promulgation of rule 10b-5, the majority rule [providing that insiders have no duty to disclose when trading with shareholders] had been effectively rendered a minority position by two developments. First, a substantial number of states adopted the 'special facts' doctrine, first articulated by the Supreme Court in 1909 in the landmark case of Strong v. Repide. Under that approach, officers and directors have had an affirmative duty to disclose nonpublic information when, in a face-to-face transaction, special circumstances or special facts render nondisclosure unconscionable. Second, several jurisdictions went so far as to require disclosure of nonpublic information to shareholders in all face-to-face transactions irrespective of any special facts or circumstances."); see also Pritchard, JusticePowell's Legacy, supra note 4, at 22-26; Stephen M. Bainbridge, Incorporating State Law Fiduciary Duties Into the Federal Insider Trading Prohibition, 52 WASH. & LEE L. REV. 1189, 1220 (1995) (opining that the special facts doctrine was more prevalent than the "duty to disclose" rule).

[192]See Pritchard, Justice Powell's Legacy, supra note 4, at 22-26 ("[T]he common law of deceit provides scant support for the proposition that a corporate insider defrauds a shareholder when the insider does not engage in a face-to-face transaction, but instead trades in an impersonal market on the basis of confidential information."); Bainbridge, supra note 104, at 1220 ("The uniform state law approach in the secondary market context remained a no duty rule."); Ash, supra note 104, at 399 ("Under what has been referred to as the 'majority rule,' an officer or director owed no duty to disclose any information even when the trading transaction was with an existing shareholder."); Charles C. Cox & Kevin S. Fogarty, Bases of Insider Trading Law, 49 OHIO ST. L.J. 353, 361 (1988) (noting that when the "Securities Act and the Securities

shareholders on impersonal marketplaces did not owe them a disclosure responsibility.[193] In reality, the Massachusetts top court stated that this notion was "supported by an imposing weight of authority in other jurisdictions" in the most well-known decision on the subject, which still reflects the majority state law perspective today.[194] Although he appeared to recognize in a footnote that this was not actually the case, Chairman Cary in the Cady, Roberts judgement argued differently.[195] In the Chiarella, Court made no mention of Cary's defining footnote, apparently relying on this section of the Cady, Roberts ruling.[196] As a result, the Chiarella Court's interpretation of the classical theory fails to explain why there is responsibility for insider trading over impersonal marketplaces.

Exchange Act were passed, classic insider trading -- transactions between uninformed shareholders and corporate officials possessing inside information --was not regarded as fraudulent in most jurisdictions" and that "[t]he corporate official's fiduciary duties were considered to run to the corporation as an entity, not to individual shareholders").

[193] See Bainbridge, supra note 104, at 1222 ("Although it is now of considerable antiquity, at least by corporate law standards, Goodwin apparently remains the prevailing state law view.").

[194] Goodwin v. Aggasiz, 186 N.E. 659, 660 (Mass. 1933). There, two insiders of the Cliff Mining Company ("Cliff Mining") purchased their company's stock over the Boston Stock Exchange while in possession of information regarding the existence of copper deposits on some of the property owned by Cliff Mining. See id. at 659-60. The Cliff Mining shareholder who had sold the stock to Aggasiz and his colleague sued on the basis that the insiders had a duty to disclose that information to the plaintiff before proceeding with the transaction.[109] The trial court agreed that the plaintiff's claim was valid as a theoretical matter but found that there was no disclosure duty in this particular case.[109] The Massachusetts high court, however, disagreed, finding that no such duty could ever exist.[109]Assuming that the information was material to the stock price, an assumption required in light of the procedural posture of the case, the court nevertheless concluded that the defendants' failure to disclose the information was not fraudulent or unlawful. See id. at 660-61. Nor could it be, for, as the court explained, corporate directors do not owe fiduciary duties to the individual shareholders. See id. at 660. Rather, they owe these duties to the corporation itself.

[195] The Chiarella Court quoted that part of Cady, Roberts where Chairman Cary opined that that "the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment." Cady, Roberts, supra note 42, at 5.

[196] It is a well-known fact that when William Cary became the Chairman of the SEC in1961, one of his primary policy goals was to overturn the decision in Goodwin v. Agassiz. See, e.g., Langevoort, supra note 49, at 1319. It was no coincidence that Cary himself authored the Cady, Roberts opinion, which effectively overturned Agassiz. But he did so simply in ignoring the majority rule articulated in Agassiz. In language that the Chiarella Court quoted, Cary boldly claimed in Cady, Roberts that "the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment." In a footnote, the Cady, Roberts decision acknowledged that this was not actually the majority rule in the courts but that "an increasing number of jurisdictions" were adopting the rule. In support of this latterproposition, Cary cited three cases: two state court cases from 1945 and 1932 and a Supreme Court case from 1909. Whatever one might think of these citations as evidence of "an increasing number of jurisdictions," none of these cited cases actually dealt with the Aggasiz issue of open market purchases by insiders.

The Securities Exchange Act of 1934's Section 10(b) serves as the foundation for American law governing insider trading, and as a result, liability for violations depends on these theories. Courts have relied on the "classical theory" for almost 40 years to explain the typical instance of insider trading, in which a corporate insider utilises knowledge obtained from his position to trade in the shares of his own firm. The classical approach states that insider trading is fraudulent when the trader owes fiduciary duties to the party on the other side of the trade, drawing on the common law of fraudulent non-disclosure.

2.2.2.2 Legal Lacuna in Classical Theory

The issue with the traditional view is that it only applies in the most specific of circumstances, such as when a corporate executive buys stock in his company as a result of important, proprietary information that belongs to his company. However, the CEO and the stockholder on the other side of the trade have a fiduciary relationship, making it dishonest for the executive to withhold the information driving the trade. However, changing practically any part of that specific hypothetical will result in issues according to the traditional theory. What happens, for instance, if the executive sells stock in his company to a person who is not yet a shareholder? What if the executive gives the information to a friend who trades with it rather than trading it themselves?

Of fact, these kinds of logical issues might not be that significant if it weren't anticipated that the classical theory would continue to influence results in unresolved cases. It is, however, and they are. Think about the issue of insider trading in debt instruments, for instance. Executives do not have a fiduciary duty to debtholders, despite the fact that information has a similar impact on the value of publicly traded debt as it does on stock. As a result, according to the classical conception, insider trading in debt is not punishable, as most courts have ruled. Or explore how repurchases are handled by the conventional paradigm. According to the traditional interpretation, a corporation's buyback of its own shares would not be subject to the insider trading prohibition

because the corporate body itself cannot be deemed to have fiduciary duties to shareholders. Given that a repurchase can boost the value of unsold shares and because the management of the firm, who are also investors, ultimately decides whether to conduct a repurchase, this may seem problematic.

2.2.2.3 The Failure of the Classical Theory

The classical theory is unable to articulate established law and fails to produce solutions that are logically persuasive when applied to unresolved law. There are a variety of factual elements that are legally important as to the finding of responsibility under the Supreme Court's insider trading jurisprudence. On the other side of the trade, the trader must act in the shareholders' best interests. [197] However, for the purposes of determining responsibility, three factual disparities are wholly immaterial. First off, it is irrelevant whether an insider uses a face-to-face transaction or an impersonal exchange to deal with respect to substantial non-public knowledge. [198]Second, whether the insider personally uses the relevant non-public information for trading purposes or transfers it to a third party for trading purposes in exchange for a personal advantage has no bearing on liability. [199]Third, whether the insider's deal involves the purchase or sale of securities is irrelevant legally. [200]These three claims—that insider trading responsibility extends to trading in impersonal marketplaces, to receiving unlawful tips, and to both purchases and sales—are, in fact, the three fixed stars in the sky of insider trading law.[201] The issue is that the classical theory is completely unable to account for these findings.

[197] Langevoort, Donald C. "Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement." *California Law Review*, vol. 70, no. 1, 1982, pp. 1–53. *JSTOR*, https://doi.org/10.2307/3480181. Accessed 12 Aug. 2021.
[198] See id. at §2:3.
[199] See id. at §2:4.
[200] See id. at §2:2.
[201] See id. at §1:8.

The fiduciary theory of insider trading, in my opinion, has outlived its utility because it falls short of what a theory should do, namely explain established law and offer answers to unresolved law that are intuitively attractive. The misappropriation hypothesis, which courts presently restrict to cases involving insider trading by "outsiders"—that is, non-employees of the firm whose stocks form the basis of the trade—should be used in place of the conventional theory in courts. The outcome would be a single, comprehensive theory of insider trading law that both clarifies what courts do and produces conclusions that are logically compelling.

2.2.3 The Tipping Theory

The Classical Theory does not address non-insiders who get and exploit important, non-public information and is largely focused on business insiders. According to the Tipping theory, outsiders who obtain "tips" of important information that is not generally known are subject to liability. [202] Insider trading and insider tipping are both prohibited activities. It entails divulging insider knowledge about a publicly traded corporation that could influence the recipient to trade its securities (such as shares or options). This is against the law since the tipped-off trader benefits unfairly from the movement in the stock price that will take place once the information is made public, giving them an advantage over other investors. [203] Tipsters can reveal insider knowledge in person, over the phone, by mail, by email, or online. Tipping is not allowed if:

- The recipient of the inside information knows or has a good basis to believe that the tipper is breaking a fiduciary duty
- The tip has the potential to benefit the tipper directly or indirectly.
- Before passing the tip on to others, the tipper anticipates the recipient will try to profit from it.

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[202] Jonathan R. Macey, 'Beyond the Personal Benefit Test: The Economics of Tipping by Insiders', Forthcoming, Journal of Law and Public Affairs Vol. 2 (2) 2017

[203] 'What is Insider Tipping' (Mystockoptions.com). last accessed on 08.12.2021

This theory was developed in Dirks v. Securities and Exchange Commission of the US.[204] According to the SEC, tippers who acquire material corporate information that they know or should know came from a corporate insider must either refrain from acting upon it or disclose it, regardless of their motivation or line of work.[205] The Supreme Court rejected the SEC's argument, as mentioned above. The Court defined the Tipping Theory in accordance with its earlier ruling in Chiarella. The Court insisted that an insider has only breached his fiduciary duty to shareholders by disclosing information to the tippee, and the tippee knows or should know that there has been a breach, and the insider must have personally benefited, directly or indirectly, from the disclosure. Only then does the tippee assume a duty to the corporation's shareholders not to trade on material nonpublic information.[206] Secrists(tippee) did not profit from the disclosure in the Dirks case, hence he did not violate his obligation. As a result, Dirks wasn't charged with insider trading and didn't inherit a fiduciary duty.[207] This established the foundation of "personal benefit" concept.

2.2.3.1 Ingredients of Tipping

According to Tipping Theory, when a tipper shares important, secret information, the duty of the tipper must be first considered, and the question of whether the tipper has violated his or her duty to shareholders should be brought up.[208] "Will the tipper benefit, directly or indirectly, from the

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[204] Dirks v. SEC, 463 U.S. 646 (1983). In this case, Raymond Dirks was a securities analyst who specialized in analyzing insurance company stocks for large institutional investors. He received a tip from Ronald Secrist, a former officer of Equity funding of America (EFA), that EFA, a diversified company primarily engaged in selling life insurance and mutual funds, had committed fraudulent corporate practices resulting in the overstatement of its assets. Dirks began to investigate, and obtained some corroboration of the allegations. Although neither Dirks nor his firm owned or traded any EFA shares, he openly discussed his investigation with a number of clients and investors, and several sold their EFA holdings. EFA's share price declined as word of the alleged corporate improprïates spread. Dirks was indicted when the California insurance seized EFA's records and discovered the fraud. The SEC then filed charges against EFA, and EFA went into receivership. Despite uncovering the fraud, Dirks was censured by the SEC for insider trading.

[205] As summarized in Thomas E. Geyer Insider Trading: Evolution, Prevailing Theories and Recent Developments, 5. For the details of the case see U.S. Supreme Court , Dirks v. SEC , 463 U.S. 646 (19/83) at http://caselaw.lp.findlaw.com/scripts/printe-friendly.pl?page+us/463/646.html(last visited Dec 6, 2020).

[206] Dirks v. SEC, 463 U.S 646 (1983), at 660

[207] Thomas E. Geyer Insider Trading: Evolution, Prevailing Theories and Recent Developments, 5-6.

[208] Ibid.,

tip?" is the test.[209] The advantage may be monetary or reputational, signify a trade-off, or take the form of a gift. The duty to refrain from trading or to disclose before trading is transferred to the tippee if the tipper violates his or her fiduciary duties.[210] In the Dirks case, the court went beyond merely noting that a tippee may inherit the insider's fiduciary duties. The Court ruled that "temporary" insiders—those who are employed by a business and have access to crucial, secret information—may be considered insiders to the degree that they have access to such knowledge.[211]

a. Knowing that a breach of the duty of confidentiality has occurred is insufficient; the tipper must have used the tip for their own benefit, and the tipee must be aware of this.

According to the government's argument in the Second Circuit, all that was required to prove guilt was that the defendants traded on important, secret information that "they knew insiders had disclosed in violation of a duty of confidentiality." Because Dirks had established that a breach was motivated by personal gain, the Second Circuit ruled that "the insider's disclosure of confidential information, standing alone, is not a breach." In other situations, breaking a duty of confidentiality might constitute a breach, but according to Dirks, it is not a breach for the purposes of determining insider trading culpability. The government must demonstrate "that the tippee knows of the personal benefit received by the insider in exchange for the disclosure," the Second Circuit ruled. In Newman, the defendants had been found guilty on different grounds, and that alone would have called for reversal and remand.

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[209] Ibid.

[210] Ibid.

[211] Temporary insider status is only effective if the corporation expects the outsider to keep nonpublic information confidential and the relationship between the parties implies a duty to do so. Thus, underwriters, lawyers, analysts, reporters, financial printers, or consultants for corporate clients who become privy to nonpublic information, are considered "temporary insiders" and are subject to insider trading liability. Individuals to whom temporary insiders convey material, nonpublic information, as tippees, are also subject to insider trading liability.

b. The Benefit to the Insider from a Tip to a "Friend" Requires a Significantly Intimate Personal Relationship

The Second Circuit made the following determination regarding who qualifies as a "friend" under Dirks's gifts-to-friends-and-relatives analysis: To the extent Dirks suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee's trades resemble trading by the insider himself followed by a gift of the profits to the recipient, we hold that such an inference is impermissible. In nutshell, friendships "Of a casual or social nature" does not fulfil the criteria.

c. The Tipper's Gain Must Be Objective, Consequential, and Indicate a Possibility of Financial Gain

The court ruled that the tipper's personal profit had to be of a "pecuniary or similarly valuable nature," and that it had to be "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." Giving the tipster access to an investment club where stock tips were frequently discussed was cited as one example of how this could be advantageous. The personal benefit of giving career advice to a tipper was insufficient since it "was little more than the encouragement one would generally expect of a fellow alumnus or casual acquaintance" and it had already begun before the insider disclosed any inside information.

d. Even a Tip to a Friend Might Not Be Enough

The court then took a strange action that is possibly at odds with the interpretation of gifts to trading friends and family members in Dirks. It stated: "[W]e hold that such an inference is impermissible in the absence of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or

similarly valuable nature." This was in reference to the principle that a gift to a trading friend or relative satisfies the Dirks personal benefit requirement. That phrase seemed to imply that, contrary to Dirks, the government required to demonstrate a substantial benefit to the insider above and above the gift itself, even in the context of a meaningfully intimate personal relationship (i.e., a friendship).

2.2.3.2 Insider Trading Liability for Tipping

The "classical theory" and the "misappropriation theory" have both been applied to impose liability for insider trading based on significant non-public information. The traditional approach, which focuses on corporate insiders, states that an insider is in breach of a duty of trust and confidence owed to the corporation and its shareholders if they trade shares of their company based on material non-public knowledge. The outsiders who do not have an obligation to the issuer or its shareholders are the subject of the misappropriation theory, in contrast. According to this idea, third parties who get important non-public information may be held accountable for insider trading if they act in violation of a fiduciary obligation to the source of the information by trading using that information. Both civil and criminal penalties for insider trading may apply to "tippees" who acquire important non-public information from "tippers" in specific situations, according to either view. Tippee responsibility may extend across a chain of recipients of such information that may be rather extensive. Thus, courts have had to deal with the challenging issues that can come up when holding "remote" tip recipients who may be several steps distant from the original source accountable for insider trading.

The Second Circuit (an influential court in securities litigation) has attempted to clarify the standards for tipper and tippee liability in SEC v. Obus.[212] "*Tipper liability* requires that (1) the

[212] SEC v. Obus, 693 F.3d 276, 284 (2d Cir. 2012)

tipper had a duty to keep material non-public information confidential; (2) the tipper breached that duty by intentionally or recklessly relying the information to a tippee who could use the information in connection with securities trading; and (3) the tipper received a personal benefit from the tip." "*Tippee liability* requires that (1) the tipper breached a duty by tipping confidential information; (2) the tippee knew or had reason to know that the tippee improperly obtained the information (i.e., that the information was obtained through the tipper's breach); and (3) the tippee, while in knowing possession of the material non-public information, used the information by trading or by tipping for his own benefit."[213]

The Obus decision attempted to clarify the standards for tippee liability, but it did not address a question that had caused conflict in the district courts: even if a tippee must be aware (or have reason to be aware) that the tipper "improperly obtained the information," must the tippee also be aware (or have reason to be aware) that the tipper "received a personal benefit from the tip" (a requirement element of tipper liability)? The answer is crucial for remote tipees, who might not even know the identity of the tipper, let alone if they personally benefited by tipping the original tipper.

In United States v. Newman, decided on December 10, 2014, the issue of whether a tipee needed to be aware that the tipper received a personal benefit in exchange for providing important nonpublic information was in dispute among lower courts in the Second Circuit. The ruling also looks to reduce the scope of what constitutes "personal benefit" by excluding "the mere fact of a friendship, particularly one of a casual or social nature."[214]

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[213] Id. May also be accessed https://www.proskauer.com/alert/second-circuit-clarifies-elements-of-tippee-liability-for-insider-trading last accessed on May 12, 2021

[214] United States v. Newman, 773 F.3d 438, 442 (2d Cir. 2014).

The Supreme Court reiterated its long-standing "personal benefit" rule for "tippee" liability in Salman v. United States.[215] Tippees are traders who act on disclosures of important nonpublic information made by insiders. The judgement was predictable given that it followed a well-established precedent, but the case's limited resolution wasted an opportunity to make explicit a hazy theory.[216] United States v. Newman was decided by the Second Circuit while his appeal was underway.[217] The Supreme Court's ruling in Dirks v. SEC more than thirty years prior limited the range of culpability for tippees in insider trading cases.[218] In contrast to Dirks, where the government merely had to demonstrate that the tipper "personally benefited" from exposing nonpublic information, the Second Circuit ruled in Newman that additional proof was necessary to establish insider trading guilt.[219] The government was specifically required to provide "proof of a meaningfully close personal relationship" between the tipper and the tipee, "that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[220] According to Salman, the Ninth Circuit should follow Newman,

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[215] 137 S. Ct. 420 (2016) Bassam Salman's case began with his brother-in-law, Maher Kara, who worked at Citigroup as an investment banker focused on the healthcare industry. As a result of his position at the bank, Maher had access to confidential information regarding mergers and acquisitions in the industry and disclosed much of this information to his brother Michael, who was a friend of Salman. Though the information sharing was initially relatively innocuous — Maher sought guidance on the basis of Michael's chemistry expertise, and the two discussed firms researching cancer treatments after their father came down with the disease — Michael eventually began trading on the information disclosed by his brother. Though Maher was at first oblivious to his brother's transactions, he soon learned of the trading and "began to assist" his brother through intentional disclosures of confidential information. What Maher did not know was that his brother had been passing along the information to other friends, including Salman. Trading on this information himself, Salman made over $1.5 million in profit before investigators uncovered the scheme. Salman was indicted and charged in the Northern District of California with four counts of securities fraud and one count of conspiracy to commit securities fraud. A jury convicted Salman on all counts, and he was sentenced to thirty-six months in prison and ordered to pay over seven hundred thousand dollars in restitution.15 After unsuccessfully moving for a new trial, Salman appealed. SC upheld 9th Ct. decision.

[216] Donna M. Nagy, Essay, Salman v. United States: Insider Trading's Tipping Point, 69 STAN. L. REV. ONLINE 28, 29–31 (2016)

[217] United States v. Newman, 773 F.3d 438, 442 (2d Cir. 2014).

[218] Dirk v. SEC, 463 U.S. 646 (1983).

[219] Newman, 773 F.3d at 452

[220] Id. But see United States v. Salman, 792 F.3d 1087, 1093 (9th Cir. 2015) (disagreeing with Newman). Newman involved the prosecution of two hedge fund investors who were at the ends of two long chains of tippers: insiders at technology firms had passed along confidential information to market analysts, who had in turn shared the information with their portfolio managers, including the defendants. Newman, 773 F.3d at 442–43. The Second Circuit found that

which according to his interpretation needed more than just proof of a family tie. Salman asserted that the government had failed to provide proof of any possible or actual financial gain of the kind that Newman had envisioned. However, the Ninth Circuit dismissed Newman and upheld Salman's conviction. Judge Rakoff found, in his opening paragraph for the panel, that Salman had not waived his position over the sufficiency of the evidence. Judge Rakoff then discussed the merits of the sufficiency allegation, noting that the personal advantage standard set forth in Dirks is met "where a 'insider makes a gift of confidential information to a trading relative or friend," in addition to when the tipper derives monetary gain. [221] This "holding of Dirks govern[ed]" Salman, according to the court. Maher's actions "precisely" fit the behaviour Dirks meant to forbid because he had admitted in court that he intended to "benefit" Michael by releasing the private information. And Salman, who was quite close to Maher and knew that Maher was the original source of the material, may deduce that Maher's disclosures were made with Michael's advantage in mind. It was evident and the jury had enough evidence to convict Salman as a result. Then, Judge Rakoff spoke to Newman directly. Judge Rakoff believed that Newman represented an unlawful change from the established course of events in light of the "clear holding of Dirks" that a variety of personal benefits satisfied its standard. [222]

And under Newman's rule, insider trading would be protected as long as the tipper did not demand any kind of tangible gain in return for the tip. Judge Rakoff rejected such a result and reaffirmed

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the government had proffered insufficient evidence to support a finding either that the tippers had received any personal benefit from the provision of information, or that the tippers and defendants had the "meaningfully close personal relationship" needed to infer a personal benefit. Id. at 452.

[221] Salman, 792 F.3d at 1090. Though failure to include an argument in an opening brief is ordinarily grounds for waiver, Salman's omission was overlooked because his "failure to raise the issue properly did not prejudice the defense of the opposing party," as both parties briefed the issue and addressed it at oral argument. Id. (quoting United States v. Ullah, 976 F.2d 509, 514 (9th Cir. 1992)).

[222] See Salman v. United States, 136 S. Ct. 899 (2016) (granting certiorari on the personal benefit question).

the Dirks standard. The Supreme Court upheld the ruling when Salman appealed.[223] Justice Alito concluded in his opinion piece for the majority Court that the Ninth Circuit had correctly applied the Dirks standard. Salman had three objections to the Ninth Circuit's definition of personal benefit: In the first place, he contended that the Dirks personal advantage test necessitates proof that the tipper intended "to obtain money, property, or something of tangible value." The second point he made was a more general one: if the personal advantage criteria is met by a broadly defined "gift," the crime of insider trading becomes unconstitutionally ambiguous.

Finally, Salman argued that the constitutional ramifications of gift-based prosecutions are "especially troubling... for remote tippees" who are less likely to be aware of the connection between the original tipper and tippee and, consequently, less likely to be aware of the original disclosure's motivation. Nevertheless, Dirks "easily resolve[d]" the case, according to Justice Alito. The Dirks Court's formulation of the personal advantage test was cited by Justice Alito. He noted that while the Court emphasised the need of objective facts in evaluating the existence of a personal benefit, it also clarified that a tipper violates a fiduciary obligation by giving a gift to a friend or relative.[224] The Dirks holding, in the opinion of Justice Alito, perfectly captured the behaviour before the Court; as a result, Dirks' "rule was sufficient to resolve the case at hand."[225] The Court drew attention to the contradiction that would result from Salman's rule being upheld:

[223] Id. ("Proof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading."). Separately, Judge Rakoff rejected Salman's appeals regarding evidentiary issues at his trial, including claims that admission of a prejudicial interview violated his Confrontation Clause rights and the Rules of Evidence, and that a jury instruction regarding "deliberate ignorance" was given in error. See United States v. Salman, 618 F. App'x 886, 888–91 (9th Cir. 2015).

[224] Id. at 428. Justice Alito also addressed Salman's argument that "many insider-trading cases . . . involved insiders who personally profited through the misuse of trading information," whereas evidence of such a profit for Maher was absent in Salman's case. Id. To Justice Alito, such an "observation does not undermine the test Dirks articulated and applied." Id.

[225] Id. at 428–29. Justice Alito also noted the rule of lenity was inapplicable to Salman, as he had failed to show the kind of "grievous ambiguity" required to invoke the rule. Id. at 429 (quoting Barber v. Thomas, 560 U.S. 474, 492 (2010)).

even though it is clearly against the law for an insider to trade using nonpublic information and then give profits to a relative, an insider could avoid this liability by giving the relative the information and allowing him to make the trades. Therefore, Dirks must be construed to encompass the latter scenario and, consequently, the behaviour at issue in Salman, for insider trading enforcement to be effective. Justice Alito also addressed the circuit split in a limited manner, stating that the Court "agree[d] with the Ninth Circuit" that any interpretation of Newman that required evidence of a financial benefit must be "inconsistent with Dirks."

Finally, Justice Alito rejected Salman's claim that the law was too ambiguous, concluding that Salman had failed to demonstrate "that either Section 10(b) itself or the Dirks gift-giving standard 'leaves grave uncertainty about how to estimate the risk posed by a crime.'" While he was aware that "even clear rules 'produce close cases,'" In Salman's case, Justice Alito ruled that Dirks' "simple and clear" threshold for tippee liability did not go as far as to be unconstitutionally vague. Salman's case was "in the heartland" of the behaviour that Dirks had in mind, thus the Court didn't have to deal with the "difficult" cases in order to decide Salman's. As a result, the Court upheld the Ninth Circuit's decision.

2.2.3.3 Legal Lacuna in Tipping Theory

The law has at least five "gaps" that could give rise to a defence even if a person trades using significant nonpublic information. These gaps include tips to people who are not close friends or relatives, restrictions on who qualifies as a "friend" for insider trading purposes, restrictions on the types of communications that qualify as gifts, the type of exchange required to demonstrate a Dirks personal benefit when the tip is to someone else, and difficulties in demonstrating remote tippee liability.

First off, it doesn't seem like an insider's tip to someone who isn't a friend or relative, and without the insider receiving a personal advantage, is actionable under Dirks. The Court refused the government's request to fill this gap in Salman. However, at oral argument, the government was unable to cite a single instance finding that gifts to recipients other than friends or family satisfy the Dirks personal benefit requirement. It may try again in a subsequent case. The justices who voiced their opinions at the Salman oral argument seemed dubious that gifts to people other than friends or family satisfied the personal benefit criterion, and much of the language in Dirks seemed to be at odds with the government's case.

Second, not every social acquaintance is a friend, even while giving gifts to friends and family members may be a personal benefit to the insider under Dirks. In Newman, the Second Circuit ruled that for Dirks' gift-to-friends analysis to be applicable, there must be a meaningfully close relationship. It claimed that social or casual interactions are insufficient.

Third, not every informational exchange between an insider and a friend or relative qualifies as a "gift" in accordance with Dirks. In Salman, the government attempted to persuade the Court to rule that any revelation of sensitive information for non-corporate reasons constitutes an illegal "gift" for insider trading purposes, but it was unsuccessful. Even if an insider has violated a duty of secrecy by exposing knowledge, the person who trades on it may not be liable for insider trading if the insider negligently shares information. The government might make an effort to show that the recipient of the information "misappropriated" it through trading, but there may not always be the required consent or understanding to justify the use of a misappropriation theory.

Fourth, the Dirks "personal benefit" requirement is onerous in the absence of a gift to a friend or relative or misappropriation. For an insider to receive compensation for disclosing knowledge,

Newman stipulates that there must be "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

Last but not the least, The foregoing rules also make it difficult for the government to prosecute remote tippees—tippees who are several tiers removed from the original tip—which is likely the most significant issue. The remote tipper must have known—or, in a civil case, at least should have known—that the information's source had broken a duty and acted selfishly in order for remote tipper liability to exist. Remote tippers frequently lack sufficient knowledge of the events leading up to the original tip for the authorities to file charges against them or establish their guilt.

2.2.3.4 Failure of Tipping Theory

The Dirks decision significantly increased the number of people who fall under the purview of insider trading rules, but it also provided at least two circumstances in which insiders' disclosure of significant, nonpublic knowledge would not constitute an insider trading offence. Firstly, An analyst who actively trades in the securities of the insider's company to whom an insider may disclose information. This is a typical practise that benefits the company because it enables analysts to value the company's securities more precisely. Since the insider who shared the information did not stand to gain personally from doing so, the analyst who received it was free to trade in the securities of the company in question without disclosing his superior knowledge. Second, there is no obligation for a person without any connections to a corporate insider who happens to overhear a conversation involving important, secret information to reveal it before buying or selling the company's stock. The second part of the three-part test for tippee responsibility outlined in Dirks is not met in this situation. Since the tipper and the corporate insider did not have a relationship, the tippee could not have known that the insider was breaking a duty that she owed to her employer. By dealing in the stocks of the implicated corporation

without first disclosing her superior information, the tippee does not contravene Section 10(b) or Rule 10b-5. The traditional insider trading theory's current framework can be found in the analysis that came before. Unless a corporate or temporary insider violates a fiduciary obligation which he owes to the corporation or its shareholders, there is no liability. Liability will not attach to the tippee unless the tippee was aware that the insider violated a duty and profited from the violationby trading on substantial, nonpublic information. Therefore, liability under the traditional definition of insider trading cannot exist in the absence of an insider receiving a benefit from disclosure. However, it is still possible to be held liable for insider trading under the misappropriation argument.

2.2.4 The Misappropriation Theory or 'Information Connected' Theory

The traditional theory of insider trading is different from misappropriation theory. The traditional perspective focuses on an insider's breach of fiduciary duty to the shareholders with whom they deal. The insider could be a corporation director, officer, or employee. The misappropriation principle, on the other hand, forbids trading by a corporate outsider who acquires confidential knowledge. Misappropriation occurs when an outsider obtains confidential or insider information about a corporation and uses it for trading. The source, who is probably a company insider, has been abused by the outsider.

2.2.4.1 Ingredients of Misappropriation Theory

The Classical and Tipping Theories require the existence of fiduciary duty towards shareholders, thus, they do not touch non-fiduciaries, and such non-Fiduciaries are those who discover material non-public information through skill i.e inappropriate means. They are outsiders but have business related relationship e.g., attorney-client, etc. In addition to this, these two theories also fail to reach non-fiduciaries who acquire material, non-public information through inappropriate means. So,

there are two basic additional criteria/ingredients to meet misappropriation, i.e., i). Non-fiduciary means trading done by outsider instead of insider on the basis of material 'information', and ii). through Inappropriate means i.e., by 'use of deceptive device' or 'contrivance'. Therefore, it is actually information-based/connected theory unlike classical and tipping theories which are person connected theories.

2.2.4.2 Liability for Insider Trading

Under the classical theory of insider trading, a corporate insider violates the anti-fraud provisions by trading in the securities of their own company on the basis of material non-public information ("MNPI") in breach of a duty owed to that company and its shareholders. By contrast, *the misappropriation theory* extends liability one step further to a person who is not an insider at a company (i.e., a corporate outsider, who is not an employee, officer or director) and prohibits these corporate outsiders from trading based on MNPI obtained in breach of a duty owed to the source of the information.

The United States v. O'Hagan[226] decision by the US Supreme Court serves as the precedent for the Misappropriation doctrine. The Securities Exchange Act of 1934's Sections 10(b) and 14(e), as well as the rules established by the Securities and Exchange Commission in accordance with these laws, Rule 10b-5 and Rule 14e-3(a), are at issue in this case, as well as their interpretation and enforcement. There are two main inquiries. The first one is about the misuse of important, secret information for the purpose of trading in stocks, and the second one is about dishonest behaviour when it comes to tender offers. We specifically address and overcome the following problems: (1) Does someone who trades in stocks for their own gain while abusing their fiduciary duty to the source of the information by misappropriating sensitive information violate Section 10(b) and Rule

[226] United States v. O' Hagan, 521 U.S. 642 (1997).

10b-5? (2) By adopting Rule 14e-3(a), which forbids trading on nondisclosed information in the context of a tender offer even in the absence of a requirement to disclose, did the Commission go beyond its authority to make rules? When considering the circumstances of this instance, our response to the first question is "yes," and to the second question, "no."[227]

Grand Metropolitan hired James O' Hagan, a lawyer in a Minneapolis law firm, in connection with a possible acquisition of the Pillsbury Company. O'Hagan became aware of the takeover preparations despite the steps Grand Met and the legal firm took to keep them secret. In the following transaction, O'Hagan bought Pillsbury shares as well as "call options," which gave him the right to buy shares in the future.[228] The moment the takeover was declared, O'Hagan made almost $4.3 million in profit when he sold his stock and options. By trading on misappropriated, non-public information he obtained while working at his legal business, O'Hagan was accused of breaching Section 10 of the SEA, 1934, as well as SEC Rules 10b-5 and 14e-3.[229] As O'Hagan was not a "insider" of Pillsbury, neither the classical theory nor the tipping theory applied to this scenario because there was no "tipper." O'Hagan was consequently charged with unlawful insider trading under the misappropriation theory, which states that "a person commits fraud in connection with a securities transaction, and as a result violates the federal anti-fraud standards, when he or she misappropriates confidential information for securities trading purposes in violation of a duty owed to the source of the information."[230] The O'Hagan case's Misappropriation thesis was accepted by the Supreme Court. The legal obligation under the Securities Acts was based on the theory that "a fiduciary's undisclosed, self-serving use of a principle's information to purchase and sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the

[227] https://www.law.cornell.edu/supct/html/96-842.ZO.html last accessed June 18, 2021
[228] Thomas E: Geyer Insider Trading: Evolution, Prevailing Theories and Recent Developments, 6.
[229] Linda, Greenhouse, "SEC argues Insider Trade Theory Before High Court," The New York Times, April 17, 1997
[230] Supra. 234

exclusive use of that information." Although the Supreme Court acknowledged that misappropriators had no independent duty to disclose to persons with whom they traded, the misappropriation theory thus satisfied the requirements for legal obligation under the Securities Acts." Misappropriation theory, henceforth, satisfied the 10(b) requirement of a "deceptive device or contrivance" used "in connection with a securities transaction." [231]

Both the Classical Theory and the Tipping Theory did not apply in this scenario since O'Hagan was not a "insider" of Pillsbury and there was no "Tipper." As a result, O'Hagan was charged with illegal insider trading under the misappropriation theory, which states that "when a person misappropriates confidential information for securities trading purposes in violation of a duty owed to the source of the information, he or she commits fraud in connection with a securities transaction and violates the federal anti-fraud standards." In the O'Hagan case, the Supreme Court agreed with the misappropriation premise. The legal obligation under the Securities Acts was based on the theory that "a fiduciary's undisclosed, self-serving use of a principle's information to purchase and sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information." The Supreme Court acknowledged that misappropriators had no independent duty to disclose to persons with whom they traded.

But perhaps things are altering. In a recent intriguing case, the Second Circuit ruled that even in the absence of a specific breach of fiduciary responsibility, insider trading may have been committed by a hacker who gained inside information by breaching a computer and traded using the knowledge. [232] The case's details are really intriguing. Ukrainian national Oleksandr Dorozhko started a trading account in October 2007. After the markets closed the same month, IMS Health Inc. was scheduled to release its financial reports. A hacker repeatedly targeted Thompson, the

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[231] Supra 235

[232] SEC v. Dorozhko, 574 F.3d 42 (2009)

investor relator, starting in the early morning of that day. At 2:15 PM, the hacker was able to download the company's still-secret financial data, which revealed that IMS's earnings per share were significantly lower than the market had anticipated. Dorozhko bought put options on the stock of IMS just before 3 o'clock. The market was informed of the bad news around 5 p.m., and when the stock market reopened the next day, the market price of the shares had decreased by about 30%. Several minutes after the market began, Dorozhko sold all of its options and made a profit of nearly $280,000. The SEC contended that the defendant broke Section 10b and Rule 10b-5 not because he disregarded a fiduciary obligation, but rather because he fraudulently gained access to inside knowledge (hacking a computer is viewed in this context as being akin to misrepresenting your identity). The Court of Appeals remanded the case in order to assess whether Mr. Dorozhko's actions qualified as a "deceptive device or contrivance," appearing to concur with the Commission.

This case is significant because it seems to go beyond violations of fiduciary obligation and to broaden the definition of misappropriation, or at the very least of misleading device. Due to the O'Hagan ruling, the misappropriation theory now ranks as the third theory of liability in today's insider trading law. The interaction between the trader and the information source is examined by the theory. The Misappropriation Theory is applicable whenever a person violates a duty due to the source of the information when they misappropriate significant, nonpublic information for use in securities trading.

2.2.4.3 Lacunas in Misappropriation Theory

a. Vagueness as to Fiduciary relation

In the case of United States v. O'Hagan, the US Supreme Court upheld the misappropriation premise but unfortunately issued a muddled decision that left many issues unanswered. During the O'Hagan dispute, there were still significant discrepancies in how lower courts used the

misappropriation doctrine.[233] Since there are numerous circumstances in which it is unclear whether a fiduciary relationship exists and if a fiduciary is prohibited from exploiting the information of his principal.

Examining these situations shows that the misappropriation idea is still incredibly nebulous, especially as a basis for criminal responsibility.[234] In Chiarella v. United States, as previously mentioned, the Court rejected the equality of access hypothesis principally on the grounds that neither the legislative history nor the text of Section 10(b) demonstrated a congressional intent to establish such a broad obligation to the market as a whole.[235] The Court did add, though, that this interpretation "would raise questions whether either criminal or civil de- fendants would be given fair notice that they have engaged in illegal activity."[236] Sadly, the misappropriation theory's case law has mostly produced the same issue.

Since Chiarella, different applications of the misappropriation theory have been made by district and appellate courts. All have arrived at a more constrained, focused spectrum of behaviour than the equality of access idea. The misappropriation argument is too nebulous since every court that has used it has envisioned a target that is different in size and shape. A hazy definition of when fiduciary relationships exist and which parties to those links have an obligation to disclose before trading on the basis of substantial, nonpublic information underlies fines, lost careers, and even jail terms.[237] This ambiguity is made worse by the fact

[233] Kimberly D. Krawiec et al., Don't Ask, Just Tell: Insider Trading After United States v. O'Hagan, 84 *Virginia Law Review* 153-228 (1998) available at: https://scholarship.law.duke.edu/faculty_scholarship/2047 last accessed July 12, 2021

[234] 445 U.S. 222 (1980).

[235] Id. at 233. Under the equality of access theory described and rejected in *Chia- rella,* "[t]he use by anyone of material information not generally available is fraudu- lent ... because such information gives certain buyers or sellers an unfair advantage over less informed buyers and sellers." Id. at 232.

[236] Id. at 235 n.20.

[237] See Elkan Abramowitz, Insider Trading: Another Chance for Clarity, N.Y. L.J., Nov. 5, 1996, at 3 (noting that the current unpredictability regarding the scope of the misappropriation theory "creates a fundamental unfairness to defendants who lack adequate notice of the legality and consequences of their actions"); Edward Brodsky, Insider Trading: The Misappropriation Theory, N.Y. LJ., Nov. 13, 1996, at 3, 7 (arguing that the case by case evolution of the

that courts sometimes target violations of fiduciary duty that have little to do with obligations owed to participants in the securities markets, departing from the goals for which the Act was intended. This is known as the misappropriation argument.

The discrepancy caused by the misappropriation theory has many real and fictitious examples. Consider, for instance, in which of the following circumstances the trader is accountable for trading based on significant, nonpublic information:

(1)(a). A psychiatrist buys or sells shares of BankAmerica Corporation after discovering from a patient, the wife of American Express's president, that her husband is running for CEO of BankAmerica;[238] or (b) the same circumstances as previously, except the wife divulges the knowledge to her hairstylist rather than her psychiatrist.[239]

(2)(a) A business chief financial officer ("CFO") admits to a priest that she has been falsifying her company's financial records in order to boost profits. Alternatively, (a) the same facts as above, but the CFO confesses her fraudulent behaviour to a fellow parishioner from whom she seeks counsel on whether to give herself in. The priest then pardons the repentant of her sins and phones his broker to place a sell order. The other parishioner phones his broker and asks for God's pardon.[240]

(3)(a) Contrary to his employer's policy against such trading, the author of the Wall Street Journal's "Heard on the Street" column engages in trading using information obtained while

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misappropriation theory has led to confusion in an area where, given the possibility of criminal sanctions, certainty is needed).

[238] See United States v. Willis, 778 F. Supp. 205 (S.D.N.Y. 1991), in which the court denied a psychiatrist's motion to dismiss an indictment for insider trading based on the breach of the fiduciary duty owed by a psychiatrist to a patient.

[239] The hairdresser example was taken from Jonn R. Beeson, Comment, Rounding the Peg To Fit the Hole: A Proposed Regulatory Reform of the Misappropriation Theory, 144 U. Pa. L. Rev. 1077, 1137 (1996). Presumably no insider trading liability would attach to the hairdresser's trades, because the relationship between client and hairdresser does not give rise to a fiduciary duty under state law.

[240] Following the logic of *Willis*, the priest is arguably guilty of insider trading under the misappropriation theory based on a breach of the fiduciary duty owed by a priest to a parishioner. Application of the misappropriation theory to the second situation, however, might require a court to delve into whether the person to whom the confession was made had a duty under applicable church doctrine not to disclose or use the information.

conducting research for the column;[241] or (b) the same circumstances as above, but the employer gives permission to the "Heard on the Street" columnist to trade on predictions that they will make the next day.[242]

(4)(a) Father, a board member of ABC Corporation, frequently divulges private information about ABC Corporation to his son, who buys ABC call options; or (4)(b) Wife, whose family founded and still controls ABC Corporation, informs her husband that the family has decided to sell the company to an acquirer at a significant premium over current market value.[243] The spouse orders his broker to buy shares in ABC Corporation the next day.[244] (S)(a) At the airline ticket desk, a passenger gives airline staff control of his garment bag. When papers describing a private merger transaction fall out of the garment bag's open side pocket, a baggage handler notices them, reads them and calls his broker; alternatively, b) another traveller grabs the garment bag off the baggage belt at the first passenger's destination, reads the papers and calls his broker.[245]

The various outcomes in the aforementioned scenarios point out a critical weakness in the misappropriation theory: Insider trading responsibility is based on a duty due to the source of the information, not on market effects or potential harm to shareholders who are selling or buying securities, or even on whether that source is indeed a market participant at all. In addition, even after removing the ambiguous "similar relationship of trust and confidence"

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[241] See Carpenter v. United States, 484 U.S. 19 (1987).

[242] The trades presumably do not violate the § lO(b) insider trading prohibition as interpreted by *O'Hagan.* See *O'Hagan,* 117 S. Ct. at 2209.

[243] The facts of the father and son example are based on United States v. Reed, 601 F. Supp. 685 (S.D.N.Y.), rev'd on other grounds, 773 F.2d 477 (2d Cir. 1985), in which an allegation that the son breached a fiduciary duty to his father by trading on confi- dential information withstood a motion to dismiss.

[244] The husband and wife example is derived from the facts of United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en bane), cert. denied, 503 U.S. 1004 (1992), in which the court held that no fiduciary or similar relationship of trust and confidence existed between the husband and wife so as to give rise under the misappropriation theory to liability of the husband's stockbroker as a "tippee."

[245] The government acknowledged in oral argument of the *O'Hagan* case that the misappropriation theory would not reach information that was stolen, absent a relationship of trust and confidence. United States Supreme Court Official Transcript, 1997 WL 182584, at *5, *O'Hagan* (No. 96-842), quoted supra note 117.

component of the test and restricting the investigation to fiduciaries in the traditional sense, the extent of a fiduciary duty may still be determined by a number of criteria, including state fiduciary duty law, a private agreement (as in the Wall Street Journal example), or the inherently personal or professional nature of a relationship (as in the parishioner, psychiatrist, and family relation examples).[246] Sadly, the extent of fiduciary obligations is not entirely obvious, especially outside of the conventional corporate insider environment.[247] In fact, this ambiguity raises questions about constitutional fairness in the context of criminal law.[248]

b. Uncertain Duties of an Attorney in Possession of Confidential Information

A fine instance of the ambiguity surrounding criminal culpability based on violation of fiduciary obligation is the attorney-client relationship. The American Bar Association's ("ABA") Model Rules of Professional Conduct ("Model Rules"), Rule 1.8(b), specifically state that "[a] lawyer shall not use information relating to a client's representation of a client to the disadvantage of the client unless the client consents after consultation." In fact, O'Hagan's conduct did not categorically violate this rule.[249] When a fiduciary inappropriately discloses sensitive information rather than using it directly, tipper and tippee liability under Section 10(b) will accrue.[250] The attorney-client privilege and the responsibility to respect client confidences, two legal doctrines pertaining to disclosure by an attorney, eloquently highlight

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[246] A fiduciary relation "need not be legal, but may be moral, social, domestic, or merely personal." Trustees of Jesse Parker Williams Hosp. v. Nisbet, 14 S.E.2d 64, 76 (Ga.1941); see also Higgins v. Chicago Title & Trust Co., 143 N.E. 482,484 (111.1924) (same).

[247] See e.g., Coffee, supra note 103, at 150 ("[11he common law has in fact always defined the term [fiduciary] with deliberate imprecision ....");United States v. Chestman, 947 F.2d 551,567 (1991) (en bane) ("[F]iduciary duties are circumscribed with some clarity in the context of shareholder relations but lack definition in other contexts."), cert. denied, 503 U.S. 1004 (1992).

[248] See infra text accompanying notes 175-179; *Chestman,* 947 F.2d at 570 ("Useful as such an elastic and expedient definition of confidential relations, *i.e.,* relations of trust and confidence, may be in the civil context, it has no place in the criminal law.").

[249] Model Rules of Professional Conduct Rule 1.8(b) (1995). For example, if a client intends to invest in certain real estate, the lawyer may not, without the client's con- sent, acquire nearby property where doing so will adversely affect the client's development plans. Id. at Rule 1.8 cmt.

[250] See Dirks v. SEC, 463 U.S. 646, 663-64 (1983) (holding that there is liability where the tippee both traded and knew that the tipper was breaching a duty by dis- closing the information).

the difference between information a client may prefer her attorney to keep confidential and information that is protected by the law. According to both principles, a lawyer is not always required to protect a client's confidentiality.[251]

Until a judge engages in insider trading based on knowledge gained during the process of deciding whether the attorney-client privilege shall apply, the attorney-client privilege and its numerous exceptions are typically not relevant to the issue of insider trading. However, the obligation to protect client confidences is significant since it ostensibly forbids attorneys from "tipping off" outsiders with secret client information, particularly those who plan to profit from it.

Even yet, on the misappropriation argument, the attorney's obligation to protect client confidences does not cleanly align with the insider trading penalties under Section l0(b). In certain situations, an attorney who divulges client information to a party who trades on it is not held accountable under Section 10(b) for the breach of duty. The Supreme Court held in Dirks v. Securities and Exchange Commission that there is no liability under Section l0(b) unless the attorney also received some benefit in return for the tip. As an illustration, an

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[251] The duty to preserve confidences focuses on the lawyer's ethical obligations, whereas the attorney-client privilege concerns the power of a court to compel testimony or production of documents. See John T. Noonan, Jr. & Richard W. Painter, Professional and Personal Responsibilities of the Lawyer 106 (1997). In some circumstances, for example, a lawyer could be compelled to testify about client secrets that he still should not willingly disclose to others. As the ABA Model Code of Professional Responsibility ("Model Code") points out, "[t]he attorney-client privilege is more limited than the ethical obligation of a lawyer to guard the confidence and secrets of his client." Model Code of Professional Responsibility EC 4-4 (1980). See also Noonan & Painter, supra, at 106 (quoting the Model Code); The Queen v. Cox and Railton, 14 Q.B.D. 153, 168 (1884) ("In order that the [privilege] may apply there must be both professional confidence and professional employment, but if the client has a criminal object in view in his communications with his solicitor one of these elements must necessarily be absent."). By contrast, lawyers, in circumstances other than where they are compelled to testify, generally have an ethical obligation to keep almost all of their clients' secrets. See Model Rules of Professional Conduct Rule 1.6(b)(l) (1995) (setting forth a narrow exception to prevent a criminal act by the client that would likely result in imminent death or serious bodily harm); Model Code of Professional Responsibility DR 4-10l(C)(3) (1980) ("A lawyer may re- veal [t]he intention of his client to commit a crime and the information necessary to prevent the crime.").

attorney violates the duty by disclosing client information to third parties without the client's consent.[252] Thus, no one—neither O'Hagan nor the other traders—would be held accountable under Section l0(b) if O'Hagan had, instead of trading, become inebriated at a pub and then, without expecting anything in return for his loose lips, violated his duty to Grand Met by disclosing the impending takeover of Pillsbury to a group of lawyers.

c. The Vagueness of Misappropriation Theory as an accepted norm for Criminal Liability

The Supreme Court has generally held that a law dictating a criminal punishment must establish a clear standard of guilt: [253] "It is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined." [254] The stand against ambiguous criminal legislation is based on two fundamental tenets. First, fairness requires that laws that impose criminal culpability be clearly specified. The Court has therefore urged again and time again that rules outlining what is considered unlawful behaviour "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." [255] In Chiarella v. United States, the Court was initially confronted with the "outsider" trading issue and noted that "[A] judicial holding that certain undefined activities 'generally are prohibited' by Section 10(b) would raise questions as to whether either

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[252] 463 U.S. 646 (1983).Id. at 662 ("Thus, the test is whether the [tipper] personally will benefit, directly or indirectly, from his disclosure."). See also SEC v. Switzer, 590 F. Supp. 756 (W.D. Okla. 1984), in which University of Oklahoma football coach Barry Switzer traded on information that he overheard from a company officer who was discussing a transac- tion with his wife; following *Dirks,* the court held that insider trading liability under

Section lO(b) could not attach because the company insider did not profit from a breach of fiduciary duty. Id. at 766.

The required benefit, however, need not be pecuniary. Tippers may, for example, seek a reputational benefit or intend to benefit a particular recipient of information, such as a close friend or relative. See *Dirks,* 463 U.S. at 663-64.

[253] See, e.g., United States v. Kozminski, 487 U.S. 931, 951-52 (1988); Grayned v. City of Rockford, 408 U.S. 104, 108-09 (1972); Screws v. United States, 325 U.S. 91,94-95 (1945).

[254] *Grayned,* 408 U.S. at 108.

[255] Id. See also Connally v. General Constr. Co., 269 U.S. 385, 391 (1926) ("[T]he terms of a penal statute creating a new offense must be sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties");Buckley v. Valeo, 424 U.S. 1, 77 (1976) ("Due process requires that a criminal statute provide adequate notice to a person of ordinary intelligence that his contemplated conduct is illegal").

criminal or civil defendants would be given fair notice that they have engaged in illegal activity."[256] Second, rules must stipulate clear criteria for those who enforce them in order to prevent arbitrary and biassed enforcement of criminal laws.[257] The three primary canons that direct courts in the judicial construction of criminal statutes are derived from these fundamental principles and were first stated by Chief Justice John Marshall in the case United States v. Wiltberger.[258]

The legislature, not the judiciary, has the authority to define crimes and set penalties for their commission. This is the first canon of judicial construction of criminal statutes.[259] This canon is based on concerns about due process in addition to the fundamental idea of separation of powers. In other words, because judicial lawmaking must be done on a case-by-case basis, it increases the risk that criminal laws and penalties may be made retroactively.[260] It is one thing to acknowledge that there is some degree of uncertainty whenever judges and juries are asked to apply substantive standards established by Congress; it would be quite another thing to tolerate the arbitrary and unfairness of a legal system in which judges would develop the standards for imposing criminal punishment on a case-by-case basis. This is what the Supreme Court said in United States v. Kozminski.[261]

The "rule of lenity," the second rule of judicial construction of criminal statutes, requires that any doubt about the applicability of a criminal statute be resolved in the defendant's favour.[262]

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[256] 445 U.S. 222,235 n.20 (1980).
[257] *Grayned,* 408 U.S. at 108-09 ("A vague law impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an *ad hoc* and subjective basis, with the attendant dangers of arbitrary and discriminatory application.").
[258] 18U.S. (5 Wheat.) 76 (1820).
[259] Id. at 95.
[260] See Bouie v. City of Columbia, 378 U.S. 347, 362-63 (1964) (reversing a criminal conviction sustained by the South Carolina Supreme Court by concluding that the broad judicial interpretation of the criminal statute at issue created an ex post facto effect and violated *Wiltberger).*
[261] 487 U.S. 931 (1988).
[262] See *Wiltberger,* 18 U.S (5 Wheat.) at 96. For examples of the rule applied, see *United States v. Granderson,* 511 U.S. 39, 54 (1994) ("Where text, structure, and his- tory fail to establish that the Government's position is unambiguously correct-we apply the rule of lenity and resolve the ambiguity in (defendant's) favor."), *United*

The rule's guiding objectives are "to promote fair notice to those subject to criminal laws, to minimise the risk of selective or arbitrary enforcement, and to maintain proper balance between Congress [and the] courts." [263]

Criminal statutes must be strictly construed, according to the third canon of judicial interpretation of criminal statutes. [264] In Wiltberger, Chief Justice Marshall remarked that "the language of a statute must authorise us to say so" in order to decide whether a case falls within its intended scope. [265] Sadly, the Court in O'Hagan condensed its analysis of these problems into the finding that scienter is required before a defendant may be found guilty of violating Section l0(b). [266] The Court stated: "To demonstrate a criminal violation of Rule lOb-5, the Government must allege that a person 'willfully' violated the requirement. A defendant who establishes that he was unaware of Rule l0b-5 may also avoid imprisonment for the offence.[267]

2.2.4.4 Revisiting the Statute to fit in Misappropriation theory

Despite the issues with the misappropriation theory, it is improbable that the Supreme Court will reconsider the matter anytime soon or recognise that it was wrong.[268] Due to this, comprehending

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States v. Thompson/Center Anns Co., 504 U.S. 505, 517-18 (1992) (plurality) (invoking the rule of lenity to resolve an ambiguity in a tax statute in defendant's favor), *Crandon v. United States,* 494 U.S. 152, 168 (1990) (applying the rule of lenity to re- solve ambiguity in favor of the defendant), and *Kozminskl* 487 U.S. at 952 (same).

[263] *Kozminski,* 487 U.S. at 952. The rule of lenity also saves ambiguous criminal statutes from constitutional attacks while at the same time enforcing the will of Congress to the maximum extent possible. "Federal crimes are defined by Congress and so long as Congress acts within its constitutional power in enacting a criminal statute, (the courts] must give effect to Congress' [will]." Id. at 939. For this reason, courts will whenever possible adopt a construction that resolves any ambiguities in favor of the defendant, thus avoiding judicial declarations of invalidity based on constitutional considerations, while at the same time attempting to enforce the legislative will to the fullest extent constitutionally permissible. See *Kozminski,* 487 U.S. at 939; Screws v. United States, 325 U.S. 91, 98-100 (1945).

[264] Commissioner v. Acker, 361 U.S. 87, 91 (1959); *Wiltberger,* 18 U.S. (5 Wheat.) at 95-96.

[265] *Wiltberger,* 18 U.S. (5 Wheat.) at 96.

[266] *O'Hagan,* 117 S. Ct. at 2214.

[267] Id. (citing 15 U.S.C. § 78ff(a) (1994) ("(N]o person shall be subject to imprison- ment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.")).

[268] While it could not easily walk away from the core misappropriation theory adopted in *O'Hagan,* perhaps the Court, if given a chance, would reject the "don't ask, just tell" aspect of its rationale by requiring consent from a principal for a fiduci- ary to trade, not merely disclosure to the principal of the fiduciary's intent to trade.

the conceptual flaws in the ruling is just as crucial as figuring out how courts will likely address the issues raised by O'Hagan.

The Supreme Court determined in O'Hagan that the misappropriation hypothesis is covered by Section 10(b)'s language, but it did not specify the parameters of the underlying fiduciary relationship that gave rise to a responsibility to disclose material, nonpublic information.[269] The Court may have defined a fiduciary connection giving rise to insider trading liability in one of two ways, and lower courts may still do so. Federal courts may first consider the pertinent state law that establishes and distinguishes fiduciary ties from other types of relationships. Second, federal courts can create a federal common law of fiduciary duty in order to direct federal securities law towards a consistent and unified definition.[270]

It may be concluded that Congress or the SEC ought to take action to replace or add to the misappropriation theory with a more precise definition of when it is and is not unlawful for corporate outsiders to trade while in possession of substantial, nonpublic information. The Supreme Court's analysis of Section 10(b) in Chiarella, Dirks, and now O'Hagan—or perhaps lack thereof—makes a strong argument that the United States should give up its common law approach to trading on material, nonpublic information and follow Europe by adding a more specific prohibition to either the Commission's rules or the statute itself rather than continuing its current practice of common law.

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[269] *Central Bank*, 511 U.S. at 187-88 (citation omitted)

[270] The choice-of-law problem was discussed extensively by Professor Bainbridge prior to the *O'Hagan* decision. See Bainbridge, supra note 31, at 1207-09. Courts adopting the misappropriation theory seemed to be creating a federal common law of confidential relationships without explicitly addressing the choice-of-law issue. See, e.g., United States v. Chestman, 947 F.2d 551, 570-71 (2d Cir. 1991) (en bane) (holding that marriage, without more, is not a fiduciary relationship with no discussion of choice of law), cert. denied, 503 U.S. 1004 (1992); SEC v. Singer, 786 F. Supp. 1158, 1169-70 (S.D.N.Y. 1992) (holding that an attorney is a fiduciary to his client without explicitly relying on state regulation of lawyers); United States v. Willis, 778 F. Supp. 205,209 (S.D.N.Y.1991) (holding that a psychiatrist-patient relationship is a fiduciary relationship with no discussion of choice of law).

2.2.5 The Misappropriation Theory Extended

According to this theory, liability will arise in the following situations: The parties involved in the communication had a reasonable expectation of privacy; and the person who provided the information was the recipient's spouse, parent, child, or sibling, unless it can be demonstrated that there was no reasonable expectation of privacy.

2.2.5.1 Ingredients of Misappropriation theory extension

The misappropriation approach unmistakably applies to situations where sensitive information is taken in violation of an existing business-related relationship, such as an attorney-client or employer-employee relationship. While in case of Falcone, Court has explored the components of the misappropriation theory extended.[271]

The rule states that a person owes a duty of trust or confidence whenever one of the following situations occurs: a. the person agrees to keep information private; b. the parties have a "history, pattern, or practise of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the information expects that the recipient will maintain its confidentiality; or c. despite the defendant's ability to refute the assumption, someone receives information from a spouse, parent, kid, or sibling.[272]

2.2.5.2 Liability under Misappropriation extension

Following the O'Hagan ruling, the US Securities and Exchange Commission (SEC) issued an administrative rule[273] to adopt a broader perspective and clarify what kinds of personal and other non-business interactions can result in liability under the misappropriation theory. [274] Family

[271] U.S. v. Falcone 257 f, 3d 226, at 232. See also Thomas E. Geyer insider Trading : Evolution, Prevailing theories and Recent Developments, 6.
[272] 5 17 C.F.R. 240.10b5-2(b).
[273] Rule 10(b)5-2 promulgated by SEC in 2000
[274] 17 C.F.R 240. 10b5-2

members and other individuals with a non-business relationship to a source of inside information are also subject to liability under Rule 10(b)5-2. The Second Circuit Court of Appeals expanded the Misappropriation Theory to include the Tippee of a Misappropriator in U.S. v. Falcone[275] in July 2001. In that situation, Joseph Falcone paid money to gain details from Business Week before the publication of the magazine to the general audience. The information was received from a magazine distributor who had violated a contractual duty to keep it secret until a predetermined release date in order to obtain it. The SEC adopted rule 10(b)5-2 in July 2002 to further define the term "duty" as it relates to the misappropriation theory. [276]

2.2.5.3 Vagueness in Mis-appropriation Extension theory

As United States v. Gansman[277] has demonstrated, the relationship of trust and confidence upon which the misappropriation argument is predicated may be converted by an accused tipper into an insider trading defence as soon as the universe of potential defendants is expanded. The misappropriation idea covers a wide range of connection kinds. Some involve customary fiduciary arrangements under common law. [278] Some are "functional equivalents" of a fiduciary

[275] U.S. v. Falcone 257 F. 3d 226 (2nd Cir. 2001).

[276] Rule 10(b)5-2 Duties of Trust or confidence in Misappropriation Insider Trading Cases.

a. Scope of Rule. This section shall apply to any violation of Section 10(b) of the act and Rule 10b-5 there under that is based on the purchase or sale of securities on the basis of ,or the communication of , material nonpublic information misappropriated in breach of a duty of trust or confidence.
b. Enumerated "duties of trust or confidence," For purposes of this section, a "duty of trust or confidence " exists in the following circumstances, among others;
    1. Whenever a person agrees to maintain information in confidence;
    2. Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material non-public information expects that the recipient will maintain its confidentiality; or
    3. Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information.

[277] 657 F.3d 85 (2d Cir. 2011), 2011 U.S. App. LEXIS 18664.

[278] United States v. Falcone, 257 F.3d 226 (2d Cir. 2001)

relationship.[279] Recently, the idea that such relationships can be imposed by consent has started to gain acceptance in the courts.[280] The twin responsibilities of confidentiality and trust/loyalty are what all of these relationships have in common.[281] The recipient of the information is forbidden by the duty of confidentiality from sharing it with others, and by the duty of trust or loyalty from using it for personal gain.[282]

The use of Rule 10b5-2 in legal matters has not yet reached a critical mass, and its full scope, particularly in criminal situations. One of the district court criticized the first prong of the rule for attempting to hold a "mere confidentiality" agreement liable without additionally needing a pledge of non-use.[283] The court decided that this component of the rule "would exceed the SEC's 10(b) authority to proscribe conduct that is deceptive" because both aspects were required to prove a breach. Although the SEC has noted that "evidence about the type of confidences shared in the past might be relevant to determining the reasonableness of the expectation of confidence," the rule does not limit the duty by the nature of the information historically shared with respect to the second prong.[284] The third prong's bright-line rule was also seen by the commission as "mitigating, to some extent, the need to study the intricacies of particular ties in the course of investigating suspected insider trading."[285]

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[279] See, e.g., United States v. Chestman, 947 F.2d 551, 569 (2d Cir. 1991) (en banc) (family relationships).
[280] See, e.g., SEC v. Cuban, 620 F.3d 551 (5th Cir. 2010); United States v. Corbin, 729 F. Supp. 2d 607, 614 (S.D.N.Y. 2010); SEC v. Nothern, 598 F. Supp. 2d 167 (D. Mass. 2009).
[281] See Cuban, 634 F. Supp. at 723 (N.D. Tex. 2009), reversed on other grounds, 620 F.3d 551 (5th Cir. 2010) (''the essence of the misappropriation theory is the . . . breach of a duty owed to the source to keep the information confidential and not to use it for personal benefit'') (citing O'Hagan, 521 U.S. at 652); but see United States v. Kim, 184 F. Supp. 2d 1006, 1011 (N.D. Cal. 2002) (imposing additional requirement that recipient of information be in position of superiority, dominance, or control).
[282] Cuban, 634 F. Supp. 2d at 725; see also Dirks, 463 U.S. at 659-60.
[283] Cuban, 634 F. Supp. 2d at 730-31. (The Fifth Circuit declined to address this point on appeal. Cuban, 620 F.3d at 558.) Cf. Corbin, 729 F. Supp. 2d at 615 (applying first prong of the rule)
[284] 2000 SEC LEXIS 1672 at *96
[285] Id. at *93.

Most likely, criminal prosecutors and civil authorities will continue to employ the misappropriation argument largely to broaden the scope of insider trading cases. However, that weapon continues to be a two-edged sword that, in the appropriate situation, may give an opportunistic defendant a defence.

2.2.6 The Mosaic Theory

2.2.6.1 Mosaic theory being 'Research Approach'

The mosaic theory is more of a methodology than a theory. The fundamental notion is that you would try to gather tidbits of information about a firm in order to try to forecast profitable investments based on its overall financial health.[286] The mosaic theory is a research strategy used by analysts in the financial industry to draw relevant conclusions from the data they have access to about a security or business. In this method, analysts gather all relevant information—public, private, and non-material—about a company or a stock and use it to determine the stock's value, which they can then use to promote the stock or share to clients.

In the modern world, analysts can gather information from a variety of lawful sources. They acquire the data, with the possibility that others will use it for insider trading, and they defend the mosaic idea. Large volumes of data are readily available in the modern age. As a result, analysts may consult a variety of sources to determine a security's true worth.[287] As a result, information analysts who utilise this approach to gather information are required to disclose the data and analysis process they employ. As employing this approach involves dealing with non-public information, analysts should be aware that doing so could result in legal consequences.

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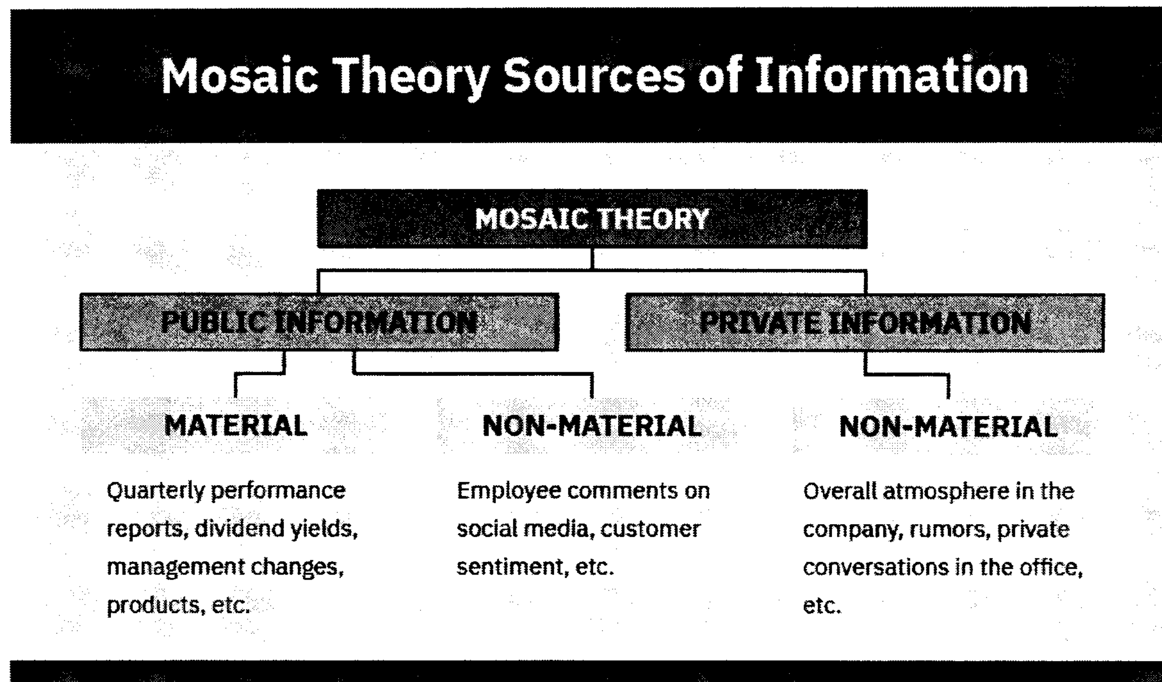
[286] FI Team, 'Mosaic Theory' (January 25, 2023) Available at : < https://corporatefinanceinstitute.com/resources/valuation/mosaic-theory/>

[287] Financial reports from the company, such as 10-K and 10-Q. Using reports of other analysts or industry experts. Information available on social platforms, such as LinkedIn, Glassdoor, etc. Insight from the company's employees and management. Google Trends. The Pew Research Center.

2.2.6.2 Ingredients of Mosaic Theory[288]



Mosaic theory mainly bifurcates sources of information into Public information[289] and Private information.[290] Information analysts who use this method of information gathering must therefore make their data and analytic methods public. Analysts should be aware that using this strategy includes dealing with non-public material, which may have legal repercussions.

a. Material Information

Any information that has a direct impact on the share prices of a firm is considered material information. Despite the fact that this is a very broad area, updates on quarterly performance, dividend yields, and management changes are frequently regarded as leading examples of material instances. Senators Richard Burr and Kelly Loeffler, for instance, ran into issues during the

[288] One of the unique characteristics of the mosaic theory is its focus on non-fundamental and speculative private data. https://tokenist.com/investing/mosaic-theory/ last accessed August 15, 2021

[289] Public information is information disclosed to the general public like when Disney announced its merger with Fox in 2019 or every year Apple reveals the new iPhone.

[290] Private information is confidential and generally unavailable. It can, obviously, be obtained in various ways from talking with employees to overhearing the CEO and the CFO talking in a cafe to coming across leaked information.

beginning of the COVID-19 outbreak. They quickly sold off a large number of equities in anticipation of the impending economic chaos because they were aware of the possible magnitude of the outbreak before the broader public.[291] Republican senators Richard M. Burr of North Carolina and Kelly Loeffler of Georgia have drawn criticism for selling off stocks worth millions of dollars each in anticipation of the recession that has coincided with the coronavirus pandemic. It is legal for senators to buy and sell stocks. However, they are now forbidden by the STOCK Act of 2012 from exploiting nonpublic information for personal gain. Since the inquiry is still ongoing as of October 2021, this case serves as an example of how difficult it may be to distinguish between lawful and illegal behaviour.

It seems that greed and incompetence were the root causes of insider trading as observed in the case of Scott London, the former partner in charge of the KPMG Southern California regional audit practise. On April 11, 2013, the SEC accused London of giving his friend, Brian Shaw, secret information regarding Skechers and Herbalife. According to court documents, Shaw, a jewellery store owner and London's country club acquaintance, paid London back with $50,000 in cash and a Rolex watch. Shaw's investment account was frozen by federal officials due to suspicious behaviour, at which point the jeweller made a complete admission, paid up roughly $2 million in illegally acquired earnings and fines to the SEC, and assisted in the investigation into London. London was given a 14-month prison term in a federal facility and was had to pay a $100,000 fine. In addition, he lost his $900,000-a-year auditor job with KPMG in 2012, forcing the company to redo a number of London's earlier audits. The company was forced to remove the audit opinions

[291] Kelly Loeffler and Richard Burr Were Briefed on Coronavirus. Then They Sold Stocks. available athttps://www.nytimes.com/2020/03/20/us/politics/kelly-loeffler-richard-burr-insider-trading.html, accessed on 22.8.2022.

on Skechers and Herbalife that London had signed.[292] The risk to audit independence presented by partners and other members of the audit engagement team trading on non-public knowledge is illustrated by these insider trading examples. Additionally, because it fosters a relationship of financial self-interest between the partner and the client, using private financial information about a client for personal gain violates the independence requirement.

b. Non-Material Information

Non-material information is data that has no bearing on a security's price. Although it doesn't immediately affect a security's price, it might give an analyst some information about the security's potential future performance. Non-material information includes things like employee satisfaction scores, how well-liked a company is in Internet searches, etc.

Information that is frequently regarded as immaterial can be discovered through conversations, reading tweets and Reddit postings, using LinkedIn, and a number of other methods you might think of. The interest of the general public in the company is yet another type of non-material information. Checking a company's popularity in Google searches is one approach to measure this.

An example of acquiring non-material information comes from a Texas institution. A certain professor noted that all of their Ph.D. students and coworkers started using Apple computers around 2005. While Macs were always at least somewhat common in academic settings, their use was skyrocketing.

[292] Securities and Exchange Commission v. Scott London et al., United States District Court for the Central District of California, Case No. CV 13 2558 RGK (PJWx)

2.2.6.3 'Caveat of Defense' using plea of Mosaic Theory approach

According to the Mosaic Theory method, one well-known case that started the conversation about the abuse of insider information was Raj Rajaratnam. The U.S. federal government was looking into Rajaratnam for insider trading. He was detained by the Federal Bureau of Investigation in 2009 and accused of 14 counts of conspiracy and securities fraud. Numerous discussions he had with insiders at organisations like Intel, Advanced Micro Devices, Clearwire, Google, Hilton, Akamai Technologies, and Goldman Sachs were made public via electronic records and wiretapped talks.[293]

Rajaratnam's legal team stated that all of his trading was based on information that was in the public domain, such as press publications, analyst reports, and business news releases. As a factor in its success and competitive advantage over other investment firms, Galleon had a reputation for conducting in-depth analyses of companies' prospects. Rajaratnam's achievement, according to lead attorney John Down, was the result of "shoe-leather research, diligence, and hard work." For instance, 51 news stories and six analyst reports speculating on a possible merger between Advanced Micro Devices and ATI Technologies were introduced as evidence by the defence. Prosecutors claim that Rajaratnam obtained inside knowledge for this particular agreement. The prosecution acknowledged that Galleon frequently conducted lawful research but contended that its staff frequently broke securities rules as well. According to a government probe, Galleon avoided losses or made profits of $72 million through insider trading.

In 2011, Rajaratnam's 14 conspiracy and securities fraud charges were all upheld as true. He was given a term of 11 years in prison, a fine of $10 million, and a forfeiture of $53 million. At the time, this was the insider trading sentence with the longest prison term. U.S. District Judge Richard

[293] U.S. v. Rajaratnam, 09 Cr. 1184 (RJH), 2007

Howell stated at the sentencing that Rajaratnam's offences "reflect a virus in our business culture that needs to be eradicated." Preet Bharara, the U.S. Attorney for Manhattan, expressed the wish that this will serve as a wake-up call. According to him, "Privileged professionals do not get a free pass to pursue profit through corrupt means." During his insider trading trial, Raj argued the mosaic argument, but the judge found him guilty.

2.3 Conclusion

"Parity-of-information" theory, Or Equal Access to Information Theory is the foundation of the prohibition against insider trading which was failed due to broad approach and it encompass everyone who possess the material non-public information. On the other hand, Classical theory imposes liability primarily on corporate insiders who trade on material, non-public information in breach of their fiduciary duty to shareholders. Under the Tipping Theory, the recipient of material, non-public information must abstain from disclosing, the provider of the information breached his or her fiduciary duty to shareholders by benefiting from the tip. The Misappropriation Theory imposes liability where a person misappropriates material, non-public information for securities trading purposes in breach of a duty owed to the source of the information. And the Misappropriation Theory may be extended to tippees where the tipper breaches a duty owed to the owner of the material, non-public information and the tippee knows that the tipper has breached the duty.

The aforementioned cases highlight how crucial the "breach of duty" element is in insider trading cases. Each theory and case, in fact, focuses on the nature of the violation of duty requirement rather than the definition of substantial nonpublic knowledge. *Chiarella* held that the duty must arise from a relationship of trust and confidence rather than a general duty not to trade on material nonpublic information; *Dirks* applied that requirement in the context of trading by a tippee, and

held that for the tippee to be liable, the insider who provided the information must have acted for the insider's personal benefit; *O'Hagan* permitted the deception element to be satisfied when the government proves that the person trading "misappropriated" the information; and *Salman* reaffirmed that a gift of information to a trading relative is sufficient to satisfy the *Dirks* personal benefit requirement.

In my opinion, only a unified approach of 'parity of information theory', classical theory and 'misappropriation theory' of insider trading would solve problems at the heart of insider trading law because it would apprehend and outlaw both Insiders and Outsiders form violating Insider trading and the same also been proposed by Zachary J. Gubler Professor of Law, at Arizona State University (ASU) - Sandra Day O'Connor College of Law.[294] Hence, in order to streamline Pakistani corporate regulatory framework and remove the vagueness/lacuna in current legal regime, I would propose that the parliamentarians and SECP should bear in mind an inclusive (unified) theory approach, while enactment/issuing regulations.

[294] A Unified Theory of Insider Trading Law, Georgetown Law Journal, Forthcoming, August 31, 2016 available on https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2832863 accessed on 30.11.2021

CHAPTER THREE

THE LAW OF INSIDER TRADING IN PAKISTAN

3.1 Introduction

Unquestionably, The Securities Act, 2015 has replaced the comprehensive 1969 Securities and Exchange Ordinance, which was passed to address the shortcomings of the earlier law and take into account changes in the securities market over time. Without a doubt, it has improved market integrity, credibility, and productivity by developing and putting into place principles that uphold morality and increase investor confidence. It was anticipated that the Securities Act 2015 will make the responsibilities related to the securities market more efficient and simplified, achieving the goals of financial professional assurance and market development. The continued effectiveness of this law and its ability to be enforced by the appropriate authorities will also be assessed. As the scope of the anti-fraud provisions to cover insider trading has grown and shrunk over time, the development of insider trading law has not advanced logically.

The law of insider trading so far has armed us with sufficient knowledge and criteria for undertaking an analysis of this law as it is applied in Pakistan. In the first introductory chapter, we tried to understand the justification for the prohibition of insider trading. A number of theories, by those who favour regulation and those who are against it, were examined. One significant point we noted was that insider trading has an intrinsic link with market manipulation or market abuse. This has special significance for Pakistan in the light of the two major crises in 2005 and 2006. In the previous chapter on the development of theories of insider trading, we saw how the law grew and the meaning of insider trading was expanded gradually.

The theories developed by the courts to identify duties owed to the source of information and misappropriation of information were analyzed. It was also noted that in the United States there

are civil remedies as well as criminal penalties, and in addition individuals can file suits too. In the law applied in the rest of the world, the main point to be seen was that insider trading was considered prohibited conduct within the larger problem of market manipulation and abuse. In the U.S. too, the law has grown from the use of deceptive devices to manipulate the market. In most countries of the world, the general approach, while defining the terms "insider" and "insider dealing" has been the "person connection" approach. A few countries have, however followed the "information connection" approach. Keeping in view all these issues and other facts, we may now examine the law of Pakistan.

3.2 The Legal Regime governing Insider Trading in Pakistan

There are a handful of laws and regulations to deal with corporate governance of Insider Trading in Pakistan. Some of the major laws are being mentioned here;

Table 1: List of Pakistani Enactments/regulations related to Insider Trading alongwith relevant Provision

Specific Laws	Year	Relevant Provisions
Securities Exchange Ordinance[295]	1969	Sec 15A-15E(1,2), Sec 17 (e)(vi)
The Securities and Exchange Rules	1971	
Companies Ordinance[296]	1984	Sec 223, Sec 224
Securities and Exchange Commission of Pakistan Act	1997	

[295] Section 15-A and 15 B, SEO, 1969 substituted by Section 15-A to 15-E through Finance Act, 2008 dated June 27 2008.

[296] Companies Act 2017 through its Section 509 repealed Companies Ordinance, 1984. Section 509 of Companies Act states; Repeal and savings.—(1) The Companies Ordinance, 1984 (XLVII of 1984), hereinafter called as repealed Ordinance, shall stand repealed, except Part VIIIA consisting of sections 282A to 282N, from the date of coming into force of this Act and the provisions of the said Part VIIIA along with all related or connected provisions of the repealed Ordinance shall be applicable mutatis mutandis to Non-banking Finance Companies in a manner as if the repealed Ordinance has not been repealed. Moreover, Section 88 deals with buyback in tender offer

The Securities and Exchange Commission of Pakistan (Appellate Bench Procedure) Rules	2003	
The Securities and Exchange Policy Board (Conduct of Business) Regulations	2000	
Listed Companies (Prohibition of Insider Trading) Regulations	2001	Paragraph 3,4,5
Proprietary Trading Regulations	2004	Sec 7(i)
The Balloters, Transfer Agents and Underwriters Rules	2001	
Public Sector Companies (Corporate Governance) Rules[297]	2013	Rule 3(7)
Securities Act	2015	Sec 101-103, 128-130, 134, 159, Part X
The Reporting and Disclosure (of shareholding by Directors, Executive Officers, Substantial Shareholders in listed Companies) Regulation	2015	Regulation 3, Regulation 2(a)(b), Regulation 5
SBP Employees Prudential Regulations	2015	G-2
Access to Inside Information Regulation	2016	
Futures Market Act	2016	
Public Offering of Securities Rules	2016	
Public Offering Regulations	2017	Regulation 17 & 22
Listed companies (buy back of securities) regulation	2019	
PSX Rule Book		Clause 5.6.1

The majority of these regulations address the misuse of insider information directly or indirectly. The goal was to protect investors from any dishonest practices by establishing a perfect information generation and circulation mechanism to reduce the misuse of insider information.

[297] Amended vide S.R.O. No. 275(I)/2017 dated April 21, 2017 and S.R.O. No. 715(I)/2019 dated July 01, 2019

The need for legislation was pressing. An amendment to the Finance Act of 1995 was the first move taken to stop this fraudulent practice in the securities market.[298] After the 2000 Stock Exchange crash, the SECP[299] adopted Chapter III-A[300] in SEO, 1969 through Finance Act 2008 which substituted Section 15-A & Section 15-B with Section 15-A to 15-E. Moreover, the prohibition of insider trading has got interlinked with market manipulation which is found in Section 17(e)(vi) of the Securities and Exchange Ordinance, 1969. In addition to that, SECP issued the Listed Companies guidelines, 2001[301]. Both of these acts constitute the foundations of Pakistani legal regime on Inside Information abuse. In order to impose transparency in trade, curb the practice of insider trading, and bring Stock Exchange operations to international standards, SECP ordered some amendments to the Articles of Association of the Karachi Stock Exchange. Later on, Securities Act was enacted in 2015 which is now the supreme enactment to prohibit Insider Trading. It has categorically prohibited the Insider trading through its Section 129. Its Part X constituted a framework for disclosure of material non-public information and the same was issued through an SRO as regulation known as Access to Inside Information Regulation, 2016.

3.3 Definition of 'Insider Trading' in Pakistani Corporate Framework and its Critical Analysis

The SE ordinance, 1969[302] and the Listed Companies (prohibition of Insiders Trading) Guidelines [303] on insider trading combine to give a complex law that is difficult to understand and is very confusing. It is challenging to imagine how such a law might be easily put into effect. The reason

[298] Finance Act (1995), available at http://www.na.gov.pk/uploads/documents/1329725424_374.pdf
[299] Securities and Exchange Commission of Pakistan.
[300] Securities and Exchange Ordinance, (Ordinance No. XVII of 1969) (28 June 1969 as amended up to 2012) available at http://www.secp.gov.pk/laws/ordinances/.
[301] Listed Companies (Prohibition of Insider Trading) Guidelines, 2001
[302] Securities and Exchange Ordinance, 1969 (Ordinance No. XVII of 1969).
[303] Listed Companies (Prohibition of Insiders Trading) Guidelines, Published by Authority, Islamabad the, 27 March, 2000.

could be that, like the laws of other nations, especially those of India, it was created and written in pieces. Pakistan should simplify its insider trading laws in the same way that India has done. The following analysis will confirm this.

3.3.1 Securities Exchange Ordinance, 1969

Insider trading definition may be deduced from Section 15A[304] which states that transacting any deal, directly or indirectly, by an 'insider'[305] person using 'inside information'[306] involving listed

[304] Exact wording of Section 15A, 1969 is: 15A. *Prohibition of insider trading.*—(1) No person shall indulge in insider trading. (2) Insider trading shall include, –
(a) an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains, or using others to transact such deals;
(b) any other person to whom inside information has been passed or disclosed by an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains, or using others to transact such deals;
(c) transaction by any person as specified in clauses (a) and (b), or any other person who knows, or ought to have known under normal and reasonable circumstances, that the information possessed and used for transacting any deal is inside information;
(d) an insider person suggesting or recommending to another person to engage in dealing in any listed securities to which the inside information possessed by the insider person pertains, without the inside information being disclosed to the person who has dealt in such securities:
(3) Nothing in this section shall apply to—
(a) any transaction performed under an agreement that was concluded before the time of gaining access to inside information; or
(b) the disclosure of inside information by an insider person as required under law.
(4) No contract shall be void or unenforceable by reason only of an offence under this section.
[305] Section 15C of SEO, 1969. *Insiders*—(1) Insiders shall include, –
(a) sponsors, executive officers and directors of an issuer;
(b) sponsors, executive officers, directors and partners of a legal person or unincorporated business association, in which the issuer holds shares or voting rights, directly or indirectly, of twenty *per cent* or more;
(c) sponsors, executive officers, directors and partners of a legal person or unincorporated business association who holds, directly or indirectly, shares or voting rights of ten *per cent* or more in an issuer;
(d) sponsors, executive officers and directors of an organization, that has been engaged in the placement of listed securities or the public offer of securities or the issuing and marketing of such securities, who has had access to insider information during his employment till a period of one year after leaving employment;
(e) any natural person holding, directly or indirectly, ten *per cent* or more shares of an issuer;
(f) sponsors, executive officers and directors of credit institutions in which the issuer has an account;
(g) any person obtaining inside information as part of his employment or when discharging his usual duties in an official capacity, or in any other way relating to work performed under contract of employment or otherwise;
(h) any person obtaining inside information through unlawful means; and
(i) a spouse, lineal ascendant or descendant, partner or nominee of a person referred to in clauses (a) to (h).
[306] Section 15B of SEO, 1969. *Inside information*—(1) The expression "inside information" means, –
(a) information which has not been made public relating, directly or indirectly, to listed securities or one or more issuers and which, if it were made public, would be likely to have an effect on the prices of those listed securities or on the price of related securities;

securities (for his advantage)[307] to which the inside information pertains, or using others to transact such deals.

3.3.1.1 Critical Analysis of definition

The definition shows it only encompass Insiders and doesn't cover the Outsiders who may misappropriate the price sensitive information for their gain. On litmus test, this definition fulfills the criteria of Classical theory or Fiduciary duty theory while totally ignores Misappropriation theory whereby an outsider including tippee will be held liable if he/she misappropriates the material information for his/her benefit. Moreover, this definition doesn't encompass equal access theory and ultimately, infringe the Parity of Information approach as well.

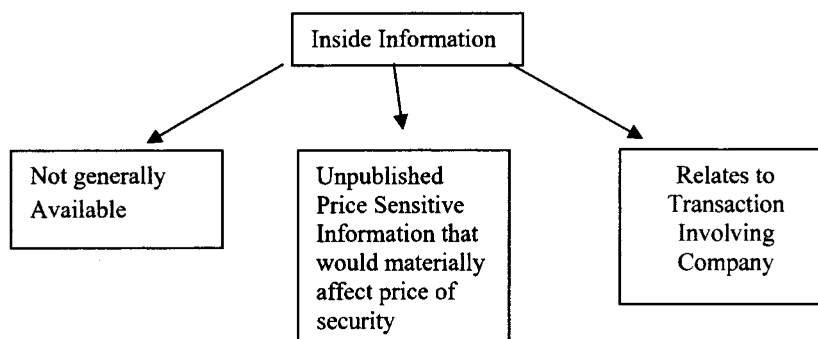


Figure 3.1: Unpublished Price Sensitive Information

(b) in relation to derivatives on commodities or information which has not been made public, relating, directly or indirectly, to one or more such derivatives and which are traded in accordance with accepted market practices on those markets; or
(c) in relation to persons responsible for the execution of orders concerning listed securities, information which is conveyed by a client to such person and related to the client's pending orders.

[307] If we see Section 17(e)(vi) of SEO, 1969 which states as; 17. Prohibition of fraudulent acts, etc. No person shall, for the purpose of inducing, dissuading, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security, directly or indirectly,- (e) do any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit or manipulation upon any person, in particular- (vi) being a director or an officer of the issuer of a listed equity security or a beneficial owner of not less than ten per cent of such security who is in possession of material facts omit to disclose any such facts while buying or selling such security.

Moreover, the definition of the term "associate," in Ordinance[308] is not the same term as "person associated with" as defined in Ordinance[309], even though the persons identified may be the same.

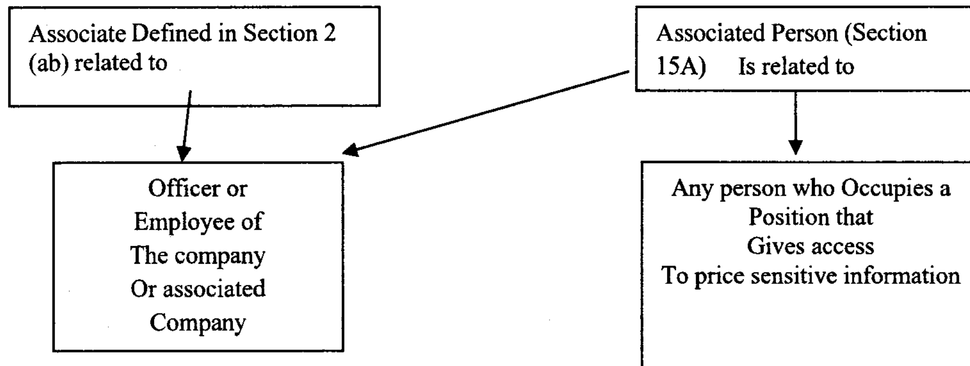


Figure 3.2: Person Associated With Company

The "person associated with the company' is prohibited from dealing in the securities of the company only if he has a certain kind of information about the company. This information is usually referred to as "unpublished price sensitive information." The section above gives three criteria for this information and the second item is further elaborated by the Guidelines. In short, The SE Ordinance 1969 introduced the concept of "associated persons," a term not used by any other law. Does the law intend the meaning of "connected person;" apparently not.

[308] Section 2 (a)(b), SE Ordinance, 1969

[309] Section 15A, SE Ordinance 1969 , already substituted by Finance Act, 2008. Now, the phrase 'person associated with' is no more par of Section 15A to 15-E of SEO 1969 after Finance Act, 2008. Section 15 A states: Section 15A of the SE Ordinance emphasize that No person who is, or has been, at any time during the preceding six months, associated with a company [309] shall, directly or indirectly, deal on a stock exchange in any listed securities of that or any other company or cause any other person to deal in securities of such company, if he has information which

a) Is not generally available:
b) Would, if it were so available, be likely to materially affect the price of those securities; or
c) Relates to any transaction (actual or contemplated) involving such company.

3.3.2 Listed Companies (Prohibition of Insider Trading) Guidelines, 2001

There is no clear cut or categorical definition of Insider trading in Listed Companies Guidelines but we can deduce from Guideline No.3 that any associate[310] (himself or on behalf of other) who remained with the company for last six months is prohibited to (i) deal in securities of a company listed on a stock exchange on the basis of any unpublished price sensitive information;[311] or (ii) communicate any unpublished price sensitive information to any person, with or without his request for such information, except as required in the ordinary course of business or under any law; or (iii) counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information.

3.3.1.1 Critical Analysis of Definition

The Guidelines suddenly come up with the definitions of "connected person" and "person deemed to be connected." They do not attempt to redefine the term" associated person." Instead, the Guidelines repeat the definition of the term "associated person." And also repeat the definition of the term "associate" as given in the Ordinance.[312] But this is not the same as "person associated with the company" as that is defined separately in the Ordinance,[313] as described above.

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[310] Paragraph 2(b) Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 states about Associates. "associate" means an associate as defined in clause (ab) of subsection (1) of section 2 of the Securities Exchange Ordinance, 1969 which says; "associate" means any partner, employee, officer or director or a member;

[311] Paragraph 2(m) Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 defines about unpublished price sensitive information. "unpublished price sensitive information" in relation to a listed security means any information which relates to the following matters or is of concern, directly or indirectly, to a company, and 4 is not generally known or published by such company for general information, but which if published or known, is likely to materially affect the price, of securities of that company in the market:- (i) financial results (both half-yearly and annual) of the company; (ii) intended declaration of dividends (both interim and final); (iii) issue of shares by way of rights, bonus, etc.; (iv) any major expansion plans or execution of new projects; (v) amalgamation, mergers and takeovers; (vi) disposal of the whole or substantially the whole of the undertaking; (vii) such other information as may affect the earnings of the company; and (viii) any changes in policies, plans or operations of the company.

[312] Section 2 (a)(b) SE Ordinance, 1984

[313] section 15A, SE Ordinance, 1984

It is quite astonishing that Guidelines discuss about “associate”,[314] “connected person”[315] and “person deemed to be connected”[316] in the ambit of “Insider”[317] but never prohibits connected person and person deemed to be connected from insider trading as depicted in Guideline 3 where it only prohibits associated person from insider trading. The definition fulfills the basic criteria of insider trading which are: (i) engaging in a securities transaction, (ii) possessing of material non-public information, and (iii) violating a duty to refrain from doing so, but the definition is vague because it doesn’t prohibit all insiders from trading on price sensitive information instead it prohibits only specific insiders, i.e., associates, from trading on price sensitive information.

In my opinion word associated should be omitted as it falls already in the definition of connected person and persons deemed to be connected. Moreover, the prohibition in guideline No.3 should be replaced from associate with connected and person deemed to be connected in order to clear the vagueness. It is quite strange that in Paragraph 4 of Guidelines, the associates are held liable

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[314] Ibid.

[315] Paragraph 2(e) Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 defines connected person. "connected person" means any person who- (i) is a director, as defined in clause (13) of sub-section (1) of section 2 of the Companies Ordinance, 1984; or (ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or 2 business relationship between himself and the company and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company

[316] Paragraph 2(k) defines person deemed to be a connected person. "person is deemed to be a connected person" if such person- 3 (i) is a company under the same management or group or any subsidiary company; (ii) is an official or a member of a stock exchange or of a clearing house of that stock exchange, or any employee of a member of a stock exchange; (iii) is an investment bank, share transfer agent, registrar to an issue, Trustee of Term Finance Certificates, Investment Advisor, Investment Company (closed end mutual fund) or an employee thereof, or, is a member of the Board of Directors of an investment company or a member of the Board of Directors of the Asset Management of an Investment Scheme (open-end mutual fund) or is an employee having fiduciary relationship with the company; (iv) is a member of the Board of Directors, or an employee, of a financial institution as defined in clause (15A) of sub-section (1) of section 2 of the companies Ordinance 1984; (v) is an official or an employee of a self-regulatory organisation recognised by the Commission; (vi) is a relative of any of the aforementioned persons; or (vii) is a banker of the company.

[317] Guideline 2(g) defines insider. “insider" means- (i) a person who is a director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company or the beneficial owner holding directly or indirectly not less than 10% of the shares of a listed company; or (ii) a person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access, by virtue of such connection, to unpublished price sensitive information in respect of securities of the company who has received or has had access to such unpublished price sensitive information;

for criminal/penal action[318] while civil liability[319] is accrued for the connected person which makes the guidelines quite cumbersome especially when it comes to judicious application of mind while adjudication.

[318] Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 Paragraph 4 states that, "A person who deals in securities or communicates any information or counsels any person dealing in securities in contravention of the provisions of paragraph 3 shall be guilty of insider trading and shall be liable to penal action under section 15B of the Ordinance." Paragraph 3 states that "No person who is or has been, at any time during the preceding six months associated with a company shall:
(i) either on his own behalf or on behalf of any other person, deal in securities of a company listed on a stock exchange on the basis of any unpublished price sensitive information; or
(ii) communicate any unpublished price sensitive information to any person, with or without his request for such information, except as required in the ordinary course of business or under any law; or
(iii) counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information.
[319] Paragraph 5 of Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 states; Liability.-(1) Every connected person who purchases, sells or otherwise deals in and with securities of an issuer with the knowledge of unpublished price sensitive information with respect to the issuer that has not been generally disclosed is liable to compensate the seller or purchaser of the securities, as the case may be, for damages as a result of the trade unless,
(a) the connected person proves that the person reasonably believed that the unpublished price sensitive information had been generally disclosed; or
(b) the unpublished price sensitive information was known or ought reasonably to have been known to the seller or purchaser, as the case may be.
(2) Every insider who informs another person of unpublished price sensitive information with respect to the issuer that has not been generally disclosed, shall be liable to compensate for damages any person that thereafter sells securities of the issuer to or purchases securities of the issuer from the person that received the Information unless;-
(i) the person who informed the other person proves that the informing person reasonably believed the unpublished price sensitive information had been generally disclosed;
(ii) the unpublished price sensitive information was known or ought reasonably to have been known to the seller or purchaser, as the case may be; or
(iii) in the case of an action against an issuer or a person in special relationship with the issuer, the information was given in the necessary course of business;
(3) Any person who has access to information concerning the investment program of a mutual fund in Pakistan or in the investment portfolio managed for a client by an investment adviser and uses that information for his, her or its direct benefit or advantage to purchase, sell or otherwise deal in and with securities of an issuer for his, her or its account where the portfolio securities of the mutual fund or the investment portfolio managed for the client by the investment adviser includes securities of that issuer is accountable to the mutual fund or the client of the investment adviser, as the case may be, for any benefit or advantage received or receivable as a result of such purchase or sale.
(4) Every person who is an insider or associate of an issuer that,-
(a) sells or purchases the securities of the issuer with knowledge of a unpublished price sensitive information with respect to the issuer that has not been generally disclosed; or
(b) communicates to another person, other than in the necessary course of business, knowledge of unpublished price sensitive information with respect to the issuer that has not been generally disclosed.
(5) Where more than one person in a special relationship with an issuer is liable under sub-paragraph (I) or (2) of this paragraph as to the same transaction or series of transactions, their liability is joint and several.
(6) In assessing damages under sub-paragraph (1) or (2) of this paragraph, the Court may consider,
(a) if the plaintiff is a purchaser, the price paid by the plaintiff for the security less the average market price of the security in the twenty trading days following general disclosure of the unpublished price sensitive information; or
(b) if the plaintiff is a vendor, the average market price of the security in the twenty trading days following general disclosure of the unpublished price sensitive information less the price received by the plaintiff for the security,

3.3.3 Securities Act, 2015

Acknowledging the fact that Insider trading has always been a market abuse since the very roots of the securities markets, the Pakistani Corporate Law: the Securities Act, 2015 outlines this terminology very comprehensively in Section 128 as insider trading[320] is transaction of any deal,

In addition to the above, the Court may consider such other measures of damages as may be relevant in the circumstances.

[320] Section 128 of Securities Act, 2015 states: 128. Prohibition of insider trading.
(1) No person shall indulge in insider trading and any contravention of this section shall be an offence.
(2) Insider trading shall include,
(a) an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals;
(b) any other person to whom inside information has been passed or disclosed by an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals;
(c) transaction by any person as specified in clauses (a) and (b) or any other person who knows or ought to have known under normal and reasonable circumstances, that the information possessed and used for transacting any deal is inside information; or
(d) an insider person passing on inside information to any other person, or suggesting or recommending to another person to engage in or dealing in such listed securities with or without the inside information being disclosed to the person who has dealt in such securities.
(3) The following shall not be deemed as insider trading:
(a) any transaction performed under an agreement that was concluded before the time of gaining access to inside information; or
(b) the disclosure of inside information by an insider person as required under law.
(4) No contract shall be void or unenforceable by reason only of an offence under this section.

directly or indirectly by (a) an insider[321] person using inside information[322] involving listed securities to which the inside information pertains or using others to transact such deals; or by (b) any other person to whom inside information has been passed or disclosed by an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals; or (c) transaction by any person as specified in clauses (a) and (b) or any other person who knows or ought to have known under normal and reasonable circumstances, that the information possessed and used for transacting any deal is inside information; or (d) an insider person passing on inside information to any other person, or suggesting or recommending to another person to engage in or dealing in

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[321] 130. Insiders.—Insiders shall include—
(a) any sponsor, executive officer or director of an issuer of listed securities;
(b) any sponsor, executive officer, director or partners of a legal person or unincorporated business association, in which the issuer holds a share or voting rights, directly or indirectly, of twenty-five per cent or more;
(c) any sponsor, executive officer director or partner of a legal person or unincorporated business association who holds, directly or indirectly, a share or voting rights of twenty per cent or more in an issuer of listed securities;
(d) any sponsor, executive officer or director of an organization that has been engaged in the placement of securities or the public offer of securities, as well as any employee of the issuer or an organization participating in the issuing and marketing of such securities who has had access to insider information during his employment, for a period of one year after leaving employment;
(e) any person holding a share, directly or indirectly, which enables him to appoint director on the board, or ten per cent or more shares of an issuer of listed securities;
(f) any sponsor, executive officer or director of a credit institution in which the issuer of listed securities has an account;
(g) any person obtaining inside information as part of his employment or when discharging his usual duties in an official capacity or in any other way relating to work performed under contract of employment or otherwise;
(h) any person obtaining inside information through unlawful means;
(i) spouse, lineal ascendant or descendant including step children partner or nominee
of a person referred to in clauses (a) to (h); and
(j) any person obtaining information or advice to trade in a security from any person referred to in clauses (a) to (i).

[322] Section 129 of Securities Act, 2015 states; 129. Inside information—For the purposes of this Part the expression "inside information" means— (a) information which has not been made public, relating, directly or indirectly, to one or more issuers of listed securities or to one or more listed securities and which, if it were made public, would be likely to have an effect on the prices of those listed securities or on the price of related listed securities;
(b) in relation to derivatives on commodities, information which has not been made public, relating, directly or indirectly, to one or more such derivatives and which are traded in accordance with accepted market practices on those markets;
(c) in relation to persons responsible for the execution of orders concerning listed securities, information which is conveyed by a client to such person and related to the client's pending orders; or
(d) information regarding decision or intentions of a person to transact any trade in listed securities.

such listed securities with or without the inside information being disclosed to the person who has dealt in such securities.

3.3.3.1 Critical Analysis of Definition

If we examine Section 128[323] critically by applying the lens of Insider Trading theories, we come to know that it comes in the frame of only two theories of Insider Trading i.e., Classical Theory, Tipping Theory, Misappropriation theory but it doesn't encompass Parity of Information Theory, Misappropriation Extension Theory and Mosaic Theory as discussed in second chapter. The litmus test of this section shows that Part (a) of Section 129 shows application of Classical theory also known as the 'Fiduciary theory' since it talks about the transaction done by the insider who owes fiduciary duty to the company and the shareholders. While Part (b) of Section 129 shows application of 'Tipping Theory' since the material price sensitive information has been passed onto someone other than insider who would do transaction (sale or purchase of security) on the basis of that information. On the other hand, Part (c) of Section 129 shows application of mix of 'Classical/Fiduciary Theory' and 'Tipping theory'.

3.4 Difference between Insider trading and Market Manipulation; Pakistani Corporate Regulations

Market manipulation refers to transactions or trading orders that give, or are likely to send, false or misleading signals about the demand, supply, or price of financial assets. Alter the price of one or more financial instruments to an abnormal or artificial level by one or more people acting together; or Use deceptive devices or any other type of fraud or scheme. Market manipulation includes the spread of rumours and false or misleading information through the media, including

[323] Section 128 of Securities Act, 2015

the Internet, or by any other means that give, or are likely to give, false or misleading signals about the supply, demand, or price of financial instruments.[324]

In Pakistan, Securities and Exchange Ordinance, 1969[325] does talk about fraudulent acts in the context of manipulation. The Ordinance makes no connection between insider trading and manipulating and abusing the market. Insider trading is actually seen as a type of market manipulation. The SE Ordinance of 1969 addresses the two ideas independently. Section 17 of Ordinance[326] deals with fraudulent acts in the context of manipulation and the use of deceptive devices under the heading of Prohibition of fraudulent acts, etc[327] while if we go through this section in detail then Section 17(e)(vi) of Ordinance (which is sub part of aforementioned section) includes the Insider trading, as well, which shows this section is inclusive or sub-category of market manipulation.

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[324] Consultation Paper No. 6 Paper 2003-06, Market Manipulation and Insider Dealing (Jersey financial Services Commission, 2006). 6.

[325] Section 17 of the Pakistan Securities and Exchange Ordinance, 1969

[326] Ibid.,

[327] Section 17, Securities and Exchange Commission Ordinance, 1969. Which states; 17. Prohibition of fraudulent acts, etc._ No person shall, for the purpose of inducing, dissuading, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security, directly or indirectly,-
(a) employ any device, scheme or artifice, or engage in any act, practice or course of business, which operates or is intended or calculated to operate as a fraud or deceit upon any person; or
(b) make any suggestion or statement as a fact of that which he does not believe to be true; or
(c) omit to state or actively conceal [a material fact] having knowledge or belief of such fact; or
(d) induce any person by deceiving him to do or omit to do anything which he would not do or omit if he were not so deceived; or
(e) do any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit or manipulation upon any person, in particular-
(i) make any fictitious quotation;
(ii) create a false and misleading appearance of active trading in any security;
(iii) effect any transaction in such security which involves no change in its beneficial ownership;
(iv) enter into an order or orders for the purchase and sale of security which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security;
(v) directly or indirectly effect a series of transactions in any security creating the appearance of active trading therein or of raising of price for the purpose of inducing its purchase by others or depressing its price for the purpose of inducing its sale by others;
(vi) being a director or an officer of the issuer of a listed equity security or a beneficial owner of not less than ten per cent of such security who is in possession of material facts omit to disclose any such facts while buying or selling such security.

If we go through Securities Act, 2015 we come to know that Market Manipulation[328] is a corporate crime which applies on any person who with a malafide intention and behavior to buy or sell himself or through his representative for his own advantage through mis-representation or fraud[329] or misleading statement[330] to induce securities transactions. This act of fraud is furthered by use

[328] Section 133, Securities Act, 2015. 133. Market manipulation—(1) A person shall commit an offence, if—
(a) he places an order, enters into or carries out, directly or indirectly any transactions, in the listed securities of a company that by themselves or in conjunction with any other transaction
(i) increase or are likely to increase, their price with the intention of inducing another person
to purchase or subscribe for or to refrain from selling securities issued by the same company or a related company;
(ii) reduce or are likely to reduce, their price with the intention of inducing another person to sell or to refrain from purchasing, securities issued by the same company or a related company;
(iii) stabilise or are likely to stabilise, their price with the intention of inducing another person to sell, purchase or subscribe for or to refrain from selling, purchasing or subscribing for, securities issued by the same company or by a related company; or
(iv) has the effect of misleading investors who trade in securities on the basis of closing prices.
(b) he, for the purposes of inducing, dissuading, effecting, preventing or in any manner influencing or turning to his advantage the sale or purchase of any security, directly or indirectly, does any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit or manipulation upon any person, in particular-
(i) makes any fictitious quotation;
(ii) creates a false and misleading appearance of active trading in any security;
(iii) effects any transaction in such security which involves no change in its beneficial
ownership;
(iv) enters into an order or orders for the purchase and sale of security which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security;
(v) directly or indirectly, effects a series of transactions in any security creating the appearance of active trading therein or of raising of price for the purpose of inducing its purchase by others or depressing its price for the purpose of inducing its sale by others;
(vi) being a director or an officer of the issuer of a listed equity security or a beneficial owner of not less than ten per cent of such security who is in possession of material facts, omits to disclose to the public through securities exchange any such facts while buying or selling such security.
[329] Section 134 of Securities Act, 2015 states; 134. Fraudulently inducing trading in securities.—A person shall commit an offence, if he induces or attempts to induce another person to subscribe for, sell or purchase securities
(a) by making or publishing any statement, promise or forecast or giving any investment advice that is false, misleading or deceptive;
(b) by any concealment of material facts; or
(c) by recording or storing in or by means of, any mechanical, electrical or other
device, information that is false or misleading in a material particular.
[330] Section 136 of Securities Act, 2015 states; 136. False or misleading statement inducing securities transactions.—
(1) A person shall commit an offence, if he, directly or indirectly, for the purpose of inducing the subscription for, sale or purchase of securities by others, of any listed company or to maintain, increase, reduce or stabilise the price of its securities, makes with respect to those securities or with respect to the operations or the past or future performance of the company—
(a) any statement or disseminates information through the media which is, at the time and in light of the circumstances in which it is made, false or misleading with respect to any material fact and which he knows or has reasonable grounds to believe to be false or misleading; or
(b) any statement or disseminates information through the media which is, by reason of the omission of a material fact, rendered false or misleading and which he knows or has reasonable grounds to believe is rendered false or misleading by reason of omission of that fact.

of deceptive device[331] as enshrined in Securities Act. This Act also deals Market manipulation separately from Insider trading on the grounds of fraud, mis-presentation and concealment. Moreover, in 2005, a study was conducted in order to ascertain effect of market manipulation in an emerging Stock market[332] with a special perspective of intermediaries' role in market manipulation. It deals mainly with economic and financial aspects but indeed provided a fair idea of market manipulation practices in Pakistan especially related to price manipulation. This study concludes that more than 44% of brokers' earnings are from manipulative practices and brokers are directly related to private information trading in the stock market. This study sheds light on the weakness of existing legal structure/framework of Pakistan.

3.5 Tubular Comparative Analysis of the Regulatory Framework

In order to ascertain the Comparative Analysis of the Provisions of the Stock Exchange Ordinance, 1969, Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 and Securities Act, 2015, help has been taken from an article[333] whereby Stock Exchange Ordinance, 1969 and Securities Act, 2015 have been compared amply but leaving Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 which is a critical corporate law without which it is impossible

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(2) A person commits an offence if he, directly or indirectly, takes advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about securities while having previously taken positions on that securities, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way.

[331] Section 135 of Securities Act, 2015. 135. Employment of fraudulent or deceptive devices.—A person shall commit an offence if he, directly or indirectly, in connection with any transaction with any other person involving the subscription for the purchase or sale of securities,—

(a) employs any device, scheme or artifice to defraud that other person;

(b) engages in any act, practice or course of business which operates as a fraud or
deception or is likely to operate as a fraud or deception, on that other person; or

(c) makes any untrue statement of a matter of fact or omits to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading.

[332] Asim Ijaz Khwaja, Atif Mian, "Unchecked Intermediaries: Price Manipulation in an Emerging Stock Market". Journal Of Financial Economics 78, no. 1 (2005): 203-241

[333] Zulfiqar, Sidra, 'The Legislative Evolution of Insider Trading Law in Pakistan', Islamabad Law Review Vol. 6, Issue 2, 2022

to identify the lacune and hazy areas of law. This comparative analysis is being made in order to examine and come up with some smart solution in the end of this thesis.

Table 2: Features of Pakistani Enactments alongwith relevant Provisions related to Insider Trading

Features	SEO, 1969	Listed Companies (Prohibition of Insider Trading) Guidelines, 2001	Securities Act, 2015
Criminal Liabilities	Under Section15E (1) in the form of fine	Under Paragraph 4 for 'Associated Person'	Under Section 159
Civil Liabilities	Under Section 15 E (2) in the form of damages	under Paragraph 5 for "Connected person'	X
Market manipulation and Insider Trading linked together	Under Section 17(e)(vi)	X	Under Section 133(1)(b)(vi)
Obligations on Intermediaries	X	X	X
Tender Offer setting addressed	X	X	X
Time to consider information public	X	X	Part X- Section 101-103. Also reflected in Reporting &

			Disclosure Regulations, 2015
Disclosure procedure available	X	X	X

3.6 Mechanism to Contain the Insider Trading

There might me many other methods to contain insider trading but it in opinion there may be two methods to contain the insider trading. 1st is the Regulatory enforcement mechanism while the 2nd one is internal mechanism of a company to contain insider trading by maintaining proper check and balance at stock exchange.

3.6.1 Regulatory & Operational Enforcement through Reforms

For the nation's economic prosperity, legal measures to prevent insider trading in firms are crucial. The most significant impediment in developing nations is the effectiveness of these rules and the process for enforcing them. Many experts believe that the success of these regulations against insider trading plays a crucial and strategic role in a nation's overall economic development. Without properly organized measures for corporate crimes and to prevent future breaches in these laws, regularizing the development projects and generating appropriate incentives for corporate entrepreneurship cannot take place. In term of the present legal regimes, the regulation for white-collar crime in Pakistan is divided among SECP, FIA[334] and NAB.[335] It is the responsibility of the

[334] Federal Investigation Agency, Pakistan established in 1974 through Federal Investigation Agency Act, 1974 deals with smuggling, Narcotics, Immigration & Passports, corporate crimes of grave nature

[335] National Accountability Bureau, Pakistan established in 1999 with the NAB Ordinance, 1999. It has responsibility of preventing and raising awareness of corruption.

SECP to provide legal framework for the market. FIA and NAB in their capacity are primarily responsible for ensuring regulatory compliance on the part of the financial intermediaries.[336]

The purpose of regulation is to address information asymmetries between counterparties to transactions, issuers and investors, clients and financial intermediaries, and clients and clients of financial intermediaries. It also aims to ensure that trading, clearing, and settlement mechanisms operate smoothly, preventing market disruption and enhancing investor confidence. The State Bank of Pakistan, commercial banks, and insurance firms make up the majority of the market for gilt-edged securities.[337] While organizations like the State Bank, commercial banks, insurance companies, municipal authorities, public corporations, and provident funds hold the majority of government securities, there is no market for corporate bonds. Only in Karachi are the major markets for gilt-edged securities present, and corporate organisations from all across the nation typically refer business to Karachi for execution. The largest holder of government securities is the banking industry. According to the law, banks must maintain a specific amount of their assets in liquid form, including unencumbered government securities, or securities that are not pledged as collateral for loans.

It is imperative to mention that a task force was established in 2005 to examine the stock market's status, look into claims of market manipulation, insider trading, and other market abuses, and recommend legislative and operational changes to improve investor safety.[338] The task report came to several conclusions, one of them being that the KSE's investigations are hampered by a variety of institutional issues that obscure the identities of those carrying out transactions. Brokers dealing

[336] A financial intermediary is an entity that acts as the middleman between two parties in a financial transaction, such as a commercial bank, investment bank, mutual fund, or pension fund. https://www.investopedia.com/terms/f/financialintermediary last accessed December 07, 2021

[337] Gilt-edged securities are high quality bond with low yield issued by government or blue chip companies like treasury bill issued by US Government

[338] Securities and exchange commission of Pakistan, Report of the Task Force: Review of the Stock market situation March 2005 (June 2005), III,(p.33-34)

through other brokers with the clear goal of hiding their tracks, as symbolised by the existence of "dhobi" brokers, have made this possible. Brokers also fail to disclose whether a trade is being executed for their own account or on behalf of a client. The Report said, "Potential insider trading and the widespread use of benami and Group accounts were further Factors that have hampered this inquiry. These elements make the KSE a murky market, which attracts manipulators."[339] Some "Research analysts" were found to be implicated in insider knowledge issues, according to the Report.[340] The Report makes the more of a generalized recommendations like proper monitoring and compliance of SOPs and regulations and colossal penalties in case of non-compliance.[341]

3.6.2 Internal Mechanism to contain the Insider Trading

In order to contain the insider trading, SECP being a regulator, has developed a mechanism by making certain rules & regulations, issuance of S.R.Os and Circulars, and creation of internal committees. The SECP has created regulations that ban brokers from engaging in insider trading in order to preserve market integrity.[342] According to these, each broker, agent, or affiliated person

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[339] Ibid.

[340] Ibid, "The Task Force noted that some research seemed to be geared to "painting" a very rosy outlook for companies and it was told that front running by brokers staff and their favoured clients was described as common. An example of research was referred to the task Force that amounted to the distribution, clearly against rules, of 'insider information' .

[341] Ibid 381 Report, sub-heading "monitoring and Surveillance of members for Market Abuse and Insider Trading";

1. It is essential that the regulators have proper surveillance and monitoring systems in place, supported by a strong compliance culture, backed by appropriate rules and penalties as well as having exchange staff fully up to date with market practices and vulnerabilities.
2. Therefore, there needs to be a concerted and determined effort within the KSE to staff both a properly functioning surveillance department with a modern array of data analysis software as well as a properly resourced and capable enforcement / prosecution function with the ability to levy meaningful and very substantial penalties (like hefty fines, suspension of trading rights for a week, etc.) with appropriate reference to the SECP for criminal prosecution of market abuse and insider trading.
3. The rules and framework in this area need considerable bolstering and if the Exchanges are not willing to undertake the necessary changes both policy and procedurally the SECP should.
4. Furthermore, it is essential not only to have adequate rules but to ensure there is a proper compliance culture in place for the rules to be effective. In addition, the rules have to be supported by a determination within the exchange to police the rules and subject abuse to heavy sanctions including large fines and suspension or expulsion of members.

[342] Proprietary Trading Regulations, 2004, Section 7 states: Market Integrity (i) Insider dealing: No broker shall, directly or indirectly, deal in any listed security or cause any other person to deal in securities of such company if he

must keep separate accounts and books for any money received or paid on behalf of each of his clients and for that person's personal account. Brokers that participate in proprietary trading are required to keep separate accounts in their own names or those of their agents or other connected parties. All transactions involving proprietary transactions must be made using the account(s).[343] According to the Public Sector Companies (Corporate Governance) Rules, 2013, a person is not qualified to become or to be made a Director or C.E.O if he is involved in insider trading.[344] In order to determine with respect to whether a person proposed to be selected as director or chief is a 'fit and appropriate person', the selecting specialists will consider any thought as it deems fit, including yet not constrained to the accompanying criteria, in particular.[345] The candidate for the

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has information which:- a) is not generally available; and b) would, if it were so available, be likely to materially affect the price of those securities

[343] https://www.dawn.com/news/374682/insider-trading-cases-prod-the-secp-to-act last visited on 23.08.2022

[344] See *ANNEXURE* [See Rule 3(7)] Criteria for Determining A 'Fit And Proper Person', Public Sector Companies (Corporate Governance) Rules, 2013 Amended vide S.R.O. No. 275(I)/2017 dated April 21, 2017 and S.R.O. No. 715(I)/2019 dated July 01, 2019.

[345] Relevant Part is as;

(1)For the purpose of determining as to whether a person proposed to be appointed as director is a 'fit and proper person', the appointing authorities shall take into account any consideration as it deems fit, including but not limited to the following criteria, namely:-

The person proposed for the said position –

(a) is at least graduate;
(b) is a reputed businessman or a recognized professional with relevant sectoral experience;
(c) has financial integrity;
(d) has no convictions or civil liabilities;
(e) is known to have competence;
(f) has good reputation and character;
(g) has the traits of efficiency and honesty;
(h) does not suffer from any disqualification to act as a director stipulated in the Ordinance;
(i) has not been subject to an order passed by the Commission cancelling the certificate of registration granted to the person individually or collectively with others on the ground of its indulging in insider trading, fraudulent and unfair trade practices or market manipulation, illegal banking, forex or deposit taking business;
(j) has not been subject to an order passed by the Commission or any other regulatory authority, withdrawing or refusing to grant any license or approval to him which has a bearing on the capital market;
(k) is not a stock broker or agent of a broker; and
(l) does not suffer from a conflict of interest; this includes political office holders whether or not in a legislative role.

(2) A director shall cease to be considered as a "fit and proper person" for the purpose, if he incurs any of the following disqualifications, namely:-

(a) he is convicted by a court for any offence involving moral turpitude, economic offence, disregard of securities and company laws or fraud;

alleged position has not been subject to a request by the Commission to revoke the recommendation of registration granted to them individually or collectively on the grounds that they engage in insider trading, dishonest and illegal exchange practises or market control, illegal account management, foreign exchange, or store keeping business.

In 2016, SECP has modified "Reporting & Disclosure (of Shareholding by Directors, Executive Officers & Substantial Shareholders in Listed Companies) Regulations 2015" through an S.R.O,[346] like through Regulation 3,[347] Reporting of beneficial ownership in the listed equity securities under section 101 to section 103 of the Act)[348], new sub-regulations (2a), (2b) (5) inserted; and through Regulation 5 (Annual return to be filed with the Commission), words "and substantial shareholders" inserted for preparing and filing online the information/particulars about substantial shareholders." These regulations had been previously circulated through an additional S.R.O.[349] that had been issued under another S.R.O.[350] The SECP has also provided guidelines regarding potential insider knowledge about the corporations. The cost of the recorded securities of a corporation may vary depending on a variety of factors, according to SECP. It is essential for the corporation to conduct a prompt assessment of the potential impact of these events and conditions on the offer price and deliberate determine whether the event or set of conditions contains inside knowledge that should be disclosed.

(b) an order for winding up has been passed against a company of which he was the officer as defined under section 305 of the Ordinance;

(c) he or his close relatives have been engaged in a business which is of the same nature as and directly competes with the business carried on by the Public Sector Company of which he is the director;

(d) he does not conduct his duties with due diligence and skill; or

his association with the Public Sector Company is likely, for whatever reason, to be detrimental to the interest of the Public Sector Company, or be otherwise undesirable.

[346] "S. R. O.967 (I)/2016, Islamabad, October 10, 2016."

[347] Reporting & Disclosure (of Shareholding by Directors, Executive Officers & Substantial Shareholders in Listed Companies) Regulations, 2015

[348] Securities Act, 2015

[349] S.R.O. 1032 (I)/2015, Islamabad, October 19, 2016.

[350] S.R.O. 887 (I)/2015, Islamabad, September 1, 2015. Read with SECP Press Release of September 3, 2015.

The SECP has made new regulations public in order to alert businesses and organizations about insider trading-related issues. The SECP has made it mandatory for every registered organization to maintain and regularly update a register to enlist people used under contract or something else who approach inside information in order to prevent insider trading at stock exchanges.

By way of an S.R.O.,[351] the SECP has issued a new regulation.[352] The same had already been circulated in the Official Gazette vide another notification.[353] Every organisation that has been registered with the SECP will keep regularly updated its register in order to include anyone who approach inside information while employed on a contract or for another reason.[354] A registered organisation will designate a senior administrative official who will be responsible for entering or removing names of individuals in the abovementioned register in a timely manner. The ibid designated officer will be required to maintain accurate records, including the justification for including or excluding names of individuals from the stated rundown, and to make them easily accessible. Organising method of the register for enrolling the persons who approach inside information is provided as a Format in Annexure-I to the aforementioned S.R.O. for chronicle names of the numerous individuals who approach insider information and that the persons recorded have recognised the requirements of Part X of the Securities Act, 2015 identifying with, to complete exchanges with the use of insider information, and to encourage the persons to whom insider information is disclosed.[355]

Through another S.R.O. [356] the SECP made new regulations called the "Public Offering Regulations, 2017". According to this new, law new functions as well as responsibilities in

[351] S.R.O.457 (1)/2016, Islamabad, May 27, 2016.
[352] Access to Inside Information Regulations, 2016.
[353] S.R.O.73 (1)/2016, Islamabad, February 1, 2016.
[354] Ibid,.
[355] Ibid,.
[356] S. R. O.296 (I)/2017, Islamabad, May 2, 2017.

connection with Insider Trading have been clarified in a sense that insider trading is prohibited for The Consultant to the Issue, Book Runner, Underwriter, Banker to an Issue and Issuing and Paying Agent (IPA).[357] The SECP has published a S.R.O. to determine how and when recorded associations and people fulfilling regulatory obligations in recorded associations can disclose inside knowledge. In this regard, the SECP has developed guidelines for businesses to disclose insider knowledge.[358] The previous strategy and process for disclosure of inside information was published, and it stated that the framework for disclosure of inside information should apply to each and every registered company, as well as to people who process inside information, release administrative duties for registered companies, and people connected to those people.[359]

For the protection of investors and to boost their trust, integrity, transparency, and fairness in the financial markets are essential. However, market abuses and dishonest trading methods like front-running and insider trading have a severe impact on this fundamental aspect of the markets.[360] This unwelcome conduct typically occurs at institutions involved in the capital markets, such as brokerage houses, mutual funds, financial institutions, and companies with large assets in the capital markets. These organizations either manage their own or other parties' portfolios, such as those of banks, DFIs (development financing institutions), insurance companies, mutual funds, pension funds, and brokerage houses, or process investment orders placed by their clients. The individual processing or taking the investment order or decision in these institutions may do it in

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[357] Section 17, Clause 8 Public Offering Regulations, 2017 relevant portion reads as: *"The Consultant to the Issue, Book Runner, Underwriter, Banker to an Issue and Issuing and Paying Agent (IPA) shall ensure that their directors and employees shall not directly or indirectly indulge in any insider trading or other market abuses."*

[358] Access to Inside Information Regulations 2016 vide SRO. 457 (I)/2016 dated 27.05.2016 issued in compliance of Section 131(2) (Listed organizations' duties to unveil inside information read with Section 169 (1) of the Securities Act 2015

[359] vide SRO. 431(I)/2012 dated 05.12.2012 under Section 15D of the SEO 1969. [Repealed by the Futures Market Act 2016 (XIV of 2016) dated 13.04.2016] Read with SECP Press Release dated 13.02.2013

[360] Front-running, a form of insider trading arises when a person engaged in processing or making investment decision/order in his official capacity uses that information for his personal benefit directly or indirectly.

front of the client or the institution itself. When a large trading order is executed in the market, the primary goal of front running is to profit from the price movement that results. The market monitoring and surveillance efforts of the SECP highlight and detect such market misconduct, for which enforcement proceedings are conducted, and the enforcement orders for which are also frequently put on the SECP website for information of the general investing public. A clear understanding of the factors influencing the control systems institutions use to identify and stop abnormalities, such as front-running and insider trading, is crucial in addition to regulatory enforcement. The SECP formed an internal committee to investigate numerous front-running/insider trading issues in light of this. The committee examined the legal and regulatory framework that the SECP is governed by in order to outlaw this offence. [361] Additionally, evaluations of the policies and restrictions implemented by different institutions were made. The analysis and findings led the committee to recommend enhancing the regulatory and legal framework to recognise and forbid such unethical trading practises through the creation of a Code of Business Conduct for Trading and Investment Practises. The aforementioned code is meant to be put into effect at all significant institutions that engage in active stock market trading, including brokerage houses, non-banking financial institutions, insurance companies, banks, and development financial organizations. [362]

In addition to advising institutions and market players on how to better supervise their workers' trading, the committee also issued recommendations for improving the way deals are executed and decisions about investments are made. The committee's investigation completely highlighted how crucial it is for internal audit to examine and rate the efficiency of the control structure. To ensure that the code and control measures are implemented effectively, the relevant regulatory body or

[361] https://www.secp.gov.pk/wp-content/uploads/2016/05/PR_July15_2011.pdf
[362] Ibid, but the code of business has still not yet developed as on April 12, 2021

ministry of these institutions will be consulted. Next are typical examples of such scenarios or circumstances where a corporation should consider whether a disclosure commitment arises[363]as depicted in footnote.[364]

The notification will clearly describe the roles and responsibilities of the business and the person in possession of the information. [365] Additionally, it shows how committed stock exchanges are to spreading information widely, preventing anyone from taking an unfair advantage of it. The recent introduction of a statutory commitment will prevent those accused of insider trading from citing legal justifications for their illegal demonstrations in the presence of obvious requirements, giving the Commission a better opportunity to indict those involved in insider trading. It is important to note that posting instructions also requires that recorded corporations distribute important information through stock exchanges. Insiders, those releasing administrative tasks in recorded firms for the purpose of disclosing information, and those connected to those releasing administrative duties in a recorded company are all included in the list of companies. In a similar

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[363] In compliance of Section 15D of SEO, 1969. '*Listed companies responsibilities to disclose inside information*'

[364] Changes in how a firm is run or how it wants to be run; adjustments to its financial situation. E.g income emergency, credit crunch; changes in charge and control assertions; changes in chiefs and (if appropriate) administrators; changes in executives" benefit contracts; changes in reviewers or some other information identified with the examiners" movement; capital, share solidification and capital decrease; issue of obligation securities, convertible instruments, alternatives or warrants to gain or buy in for securities; take-overs and mergers; buy or transfer of value premiums or other significant resources or business activities; development of a joint endeavor; restructurings, rearrangements, de-merger and turn offs that affect the enterprise's' advantages, liabilities, money related position or benefits and misfortunes; choices concerning repurchase projects or exchanges in other recorded monetary instruments; changes to the reminder and articles; documenting of twisting up petitions, the issuing of twisting up requests or the arrangement of temporary directors or outlets; legitimate debate and procedures; Disavowal or withdrawal of credit lines by at least one bank; devaluation of benefits; borrower debt; reduction in the value of genuine properties; physical destruction of uninsured goods; new licences; licences; and enrolled trademarks; a decrease in the value of licences or rights or elusive resources due to market growth; an increase in the value of financial instruments in a portfolio that include financial resources or liabilities arising from prospects contracts, subsidiaries, warrants, swaps, defensive supports, or credit default swaps; Orders received from clients, their loss or necessary changes, their departure from or entry into new core business regions, changes to the venture strategy, changes to the bookkeeping method, changes to the ex-profit date, changes to the profit installment date and measure of profit, changes to the profit arrangement, divestment by larger investors, and vow of the principal

[365] Access to Inside Information Regulations 2016 vide SRO. 457 (I)/2016 dated 27.05.2016 issued in compliance of Section 131(2) (Listed organizations' duties to unveil inside information read with Section 169 (1) of the Securities Act 2015

pattern, the SECP has approved and strengthened legal framework to satisfy the mandatory requirements of Section 15D, whereby the Commission has decided a method to disclose the crucial information to the Commission and the general public through the stock exchanges.[366] This is done in accordance with universal practises and the current legal arrangements.

Insider trading is the practise of insiders with access to proprietary corporate information dealing in the stocks of a publicly traded company. The notification has specified the minimum standards with respect to insider knowledge that the listed firms and other individuals mentioned above must agree to. The obligation of listed firms is that the disclosure must be provided in a fashion that permits equitable, timely, and successful access by the general public to the financially sensitive financial information.[367]

SECP, being top regulatory body, has issued a notification stating that all registered companies and the individuals will immediately document with the Commission and simultaneously transmit the same to the stock exchange(s) on which it is listed. By encouraging and facilitating self-

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[366] Section 15D of SEO, 1969. *Listed companies responsibilities to disclose inside information.*—(1) Listed companies shall inform the public, in the manner specified by the Commission, as soon as possible of inside information which directly concerns the listed securities.
(2) Listed companies may delay the public disclosure of inside information, as referred to in sub-section (1) in order not to prejudice their legitimate interests, provided that such delay does not mislead the public and provided that the company is able to ensure the confidentiality of the information and the company shall inform the Commission of the decision to delay the public disclosure of inside information forthwith.
(3) Whenever a listed company or a person acting on its behalf, discloses any inside information to any third party in the normal exercise of employment, profession or duties, complete and effective public disclosure of that information must be made simultaneously in the manner specified by the Commission:
Provided that the provisions shall not apply if the person receiving the information owes a duty of confidentiality, regardless of whether such duty is based on a law, regulations, articles of association or contract.
(4) Listed companies or persons acting on its behalf, shall maintain and regularly update a list of persons employed, under contract or otherwise in the manner specified by the Commission who have access to inside information and provide such list to the Commission whenever the Commission requests it.
(5) Persons discharging managerial responsibilities within a listed company and, where applicable, persons closely associated with them, shall notify the Commission of transactions conducted on their own account relating to the securities of such listed company in the manner specified by the Commission.
(6) The Exchanges shall adopt structural provisions, operating procedures and surveillance techniques to detect and prevent insider trading and market abuse practices, within such time as may be specified by the Commission and according to the regulations made hereunder.
[367] Access to Inside Information Regulations 2016 issued vide SRO. 457 (I)/2016 dated 27.05.2016

regulation by market participants and institutions to prevent and control unfair trading practises, the implementation of these recommendations will complement the SECP's primary goal of promoting fairness and boosting efficiency in the capital markets.

3.7 Penalties of Insider Trading in Pakistani Legal Setup

First of all, the regulatory framework of Pakistan will be enshrined along with the penalties and thereafter its analysis will be done to find pitfalls of which the accused may take benefit if the same is not amended in letter and spirit.

Table 3: Penal Provision in Regulatory Framework of Pakistan

Specific Laws	Year	Relevant Prohibitory Provision	Relevant Penal Provision	Max. Fines & Fees	Max. Prison time
Securities Exchange Ordinance[368]	1969	Section 15A. Insider trading (Sec.15A), Inside Information (Sec.15B), Insider (Sec.15C)	Section 15E (E1 fixes Criminal Liability while E2 fixes Civil liability	Rs.10Mn or three times the amount of gain made or loss avoided by such person, whichever amount is higher.	03 years[369]

[368] Section 15-A and 15 B, SEO, 1969 substituted by Section 15-A to 15-E through Finance Act, 2008 dated June 27 2008.

[369] Section 24 of SEO, 1969 which says Whoever contravenes the provisions of section 17 shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to [five hundred] thousand rupees, or with both. If we read Section 17 (e)(vi) specifically which states 17.No person shall, for the purpose of inducing, dissuading, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security, directly or indirectly,- e. do any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit or manipulation upon any person, in particular- vi. being a director or an officer of the issuer of a listed equity security or a beneficial owner of not less than ten per cent of such security who is in possession of material facts omit to disclose any such facts while buying or selling such security.

Companies Ordinance[370]	1984	223 relates to Short sale while 224(1) relates to short swing[371]	Section 224(4)	Fine up to Rs. 30,000	
Listed Companies (Prohibition of Insider Trading) Regulations	2001	Paragraph 3 prohibit Associates. However, Paragraph 5 prohibits Connected Person	Paragraph 4 Penal Provision for 'Associate' Under Paragraph 5 Civil Liability for 'Connected person'	Penal action under 15B of SEO after amendment in Finance Act, 2008, 15E of SEO i.e., liable to fine, which may extend to ten million rupees or three times the amount of gain made or loss avoided by such person, or loss suffered by another person, whichever amount is higher. But, civil liability of compensation in the form of damages	-
Securities Act	2015	Prohibition under Section 128. Insider trading (Sec.128), Inside Information (Sec.129),	Section 159	Upto Rs.200Mn or three times the amount of gain made or loss avoided by such person, whichever amount is higher.	03 years

[370] Repealed by Companies Act, 2017. However, interestingly, there is no mentioning of short swing and short sale in latest enactment which is mindboggling.
[371] Exact Replica of Section 16 of SEA, 1934

		Insider (Sec.130)			
The Reporting and Disclosure Regulations	2015	Prevailing law for Disclosure procedure of Shareholding by Directors, Executive Officers & Potential Shareholders in Listed Companies. (in line of Sec 101 to 103 of Securities Act, 2015	-	Profit made on sale or purchase of stock within 6 months	-
Access to Inside Information Regulation	2016	Paragraph 2 and Annex-I	Prohibition to conclude transaction on the basis of Insider Information in Compliance of Part X, Securities Act, 2015	-	-

3.7.1 Analysis of effectiveness of prohibitory clauses

The Ordinance prohibits an insider from buying or selling its own securities when such insider is in possession of material facts and omits to disclose such facts while buying or selling securities.[372]

[372] Section 15A of SEO, 1969. *Prohibition of insider trading.*—(1) No person shall indulge in insider trading. (2) Insider trading shall include, –
(a) an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains, or using others to transact such deals;
(b) any other person to whom inside information has been passed or disclosed by an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains, or using others to transact such deals;
(c) transaction by any person as specified in clauses (a) and (b), or any other person who knows, or ought to have known under normal and reasonable circumstances, that the information possessed and used for transacting any deal is inside information;

Before, it allows a shareholder to bring an action for damages against an insider for violation of insider trading laws under Section 15B of SEO, 1969 (abrogated)[373] but the same has been amended and replaced from civil liability to criminal liability by applying penal action through Finance Act, 2008.[374] Moreover, Under Section 15 E (2) there is civil liability in the form of

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(d) an insider person suggesting or recommending to another person to engage in dealing in any listed securities to which the inside information possessed by the insider person pertains, without the inside information being disclosed to the person who has dealt in such securities:
(3) Nothing in this section shall apply to—
(a) any transaction performed under an agreement that was concluded before the time of gaining access to inside information; or
(b) the disclosure of inside information by an insider person as required under law.
(4) No contract shall be void or unenforceable by reason only of an offence under this section.

[373] Section 15-A and 15 B substituted by 15 A to 15 E through Finance Act, 2008 dated June 27 2008. The substituted section 15B read as under:
15 B. *Liability for contravention*.- (1) Where a person contravenes the provisions of section 15A, the Authority may, by a notice in writing, ask such person to show cause for compensating any person who has suffered loss for such contravention and initiating prosecution against him.
(2) Where a person to whom a notice has been issued under sub-section (1) satisfy the Authority that -
(a) any dealing on stock exchange or communication of any information was not made with the intent of making any profit or causing a loss to any person or company; or
(b) the dealing on stock exchange or any information was communicated in good faith in discharge of his legal responsibilities.
the Authority may withdraw such notice.
(3) Where the Authority is not satisfied with the explanation of the person given in response to the show cause notice served upon him under sub-section (1), it may direct him to pay any other person who has suffered loss for any contravention of section 15A, compensation which shall not be less than the amount of loss sustained by any other person as a result of such dealing or communication of information:
Provided that where the person who has suffered any loss for any contravention of section 15A is not determined, the amount of compensation equivalent to the gain accrued or the loss avoided by such contravention, shall be payable to the [Commission].
(4) In addition to compensation payable under sub-section (3), a person contravening the provisions of section 15A shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to three times the amount of gain accrued or loss avoided by such contravention, or with both.
(5) Any compensation payable under this section shall be recoverable as arrear of land revenue.

[374] 15E. *Liability for contravention.*—(1) Any person who contravenes the provisions of sub- section (1) of section 15A shall, on being found guilty of contravention by the Commission, be liable to fine, which may extend to ten million rupees or three times the amount of gain made or loss avoided by such person, or loss suffered by another person, whichever amount is higher.
(2) In addition to the fine imposed under sub-section (1), such person,– (a) may be directed by the Commission, –
(i) to surrender to the Commission, an amount equivalent to the gain made or loss avoided by him; or
(ii) to pay any other person who has suffered a loss, an amount equivalent to the loss so suffered by such person; and
(b) may, where such person is an executive officer, director, auditor, advisor, consultant of a listed company, be removed from such office by an order of the Commission and debarred from auditing any listed company for a period of upto three years; or
(c) may, where such person is registered as a broker or agent, be liable to cancellation of registration.
(3) Where an insider person discloses inside information to any other person who is not required to possess such information for any reason, the insider person shall be liable to fine, to be imposed by the Commission, which may extend to thirty million rupees.

damages in addition to the criminal liability of fine imposed under 15E(1).[375] The Ordinance fixed the liability for contravention of section 15A of the Ordinance because Section 15A speaks in terms of the "associated person "and the liability here is of such person. The "Associated person "as already stated may be an officer or employee of the company whose securities are traded or of an associated company or he may be a person who occupies a position which gives him access to inside information "by reason of any professional or business relationship between him or his employer or a company or associated company of which he is a Director."[376] Now such a person is a true insider, but he is not called as such by the guidelines.[377]

Section 17(e)(vi) of SEO, 1969 interlinks Market Manipulation with Insider trading.[378] With regard to the penalties that may be imposed for violation of insider trading laws under Section

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(4) The Commission may, by notification in the official Gazette, make regulations to regulate persons who produce or disseminate research concerning listed securities or issuers of listed securities and persons who produce or disseminate other information recommending or suggesting investment strategy, intended for distribution channels or for the general public.]

[375] Ibid.

[376] Section 15A of Securities and exchange ordinance, 1969 (ordinance No. XVIII Of 1969) 28th June, 1969, as amended up to 7th September, 2000).

[377] Listed Securities (Prohibition of Insider Trading) Guidelines, 2001

[378] Section 17, SEO, 1969. *Prohibition of fraudulent acts, etc.*_ No person shall, for the purpose of inducing, dissuading, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security, directly or indirectly,-

(a) employ any device, scheme or artifice, or engage in any act, practice or course of business, which operates or is intended or calculated to operate as a fraud or deceit upon any person; or

(b) make any suggestion or statement as a fact of that which he does not believe to be true; or

(c) omit to state or actively conceal [a material fact] having knowledge or belief of such fact; or

(d) induce any person by deceiving him to do or omit to do any thing which he would not do or omit if he were not so deceived; or

(e) do any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit or manipulation upon any person, in particular-

(i) make any fictitious quotation;

(ii) create a false and misleading appearance of active trading in any security;

(iii) effect any transaction in such security which involves no change in its beneficial ownership;

(iv) enter into an order or orders for the purchase and sale of security which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security;

(v) directly or indirectly effect a series of transactions in any security creating the appearance of active trading therein or of raising of price for the purpose of inducing its purchase by others or depressing its price for the purpose of inducing its sale by others;

(vi) being a director or an officer of the issuer of a listed equity security or a beneficial owner of not less than ten per cent of such security who is in possession of material facts omit to disclose any such facts while buying or selling such security.

17(e)(vi) of Securities and Exchange Ordinance, sub section 1 of Section 24 makes a violation of insider trading laws, under the Ordinance a criminal offence and is punishable with imprisonment for a term that may extend to three years or with a fine that may extend to Rs. 10,000 or with both.[379] Sub-section 2 of Section 24-unlike a typical fraud case where the onus is on the claimant to prove the fraud-where a corporate body is guilty of insider trading laws, its directors, manager or other officers shall also be presumed guilty unless they can rebut this presumption by proving that exercised all diligence to prevent its commission.[380] It is suggested that through the monetary fines may be raised to increase its deterrent effect, imposition of jail terms at the present time appears inappropriate. Jail terms may be more suitable only after regulators by imposing monetary fines and tougher enforcement have made insiders sensitive in the fact that insider trading is a criminal offence and will be penalized. At present, it does not even appear to be prevalent belief that insider trading is a forbidden practice.

[379] Section 24, SEO, 1969. *Penalty.* (1) Whoever contravenes the provisions of section 17 shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to [five hundred] thousand rupees, or with both.
(2) Where the person guilty of an offence referred to in sub-section (1) is a company or other body corporate, every director, manager or other officer responsible for the conduct of its affairs shall, unless he proves that the offence was committed without his knowledge or that he exercised all diligence to prevent its commission, be deemed to be guilty of the offence.
[380] Ibid.

Short selling[381] and short swing profits[382] are prohibited under Companies Ordinance, 1984.[383] Section 224 of the Companies Ordinance 1984 requires the insiders to report to the Securities and Exchange Commission of Pakistan (SECP), regarding purchases and sales of their own company's securities within a period of less than six months. Any gains by such insiders within six months are made recoverable by the company.[384] It is noteworthy that liability is imposed only if there is a specific intent to violate the statute. A person who fails to comply with the statute because of negligence, perhaps even gross negligence, may avoid penalties prescribed for violation as per Proviso of Section 224[385]. There is criminal liability in case of violation of short selling and swing profits.[386]

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[381] Short selling involves borrowing a security whose price you think is going to fall from your brokerage and selling it on the open market. Your plan is to then buy the same stock back later, hopefully for a lower price than you initially sold it for, and pocket the difference after repaying the initial loan.
For example, let's say a stock is trading at $50 a share. You borrow 100 shares and sell them for $5,000. The price suddenly declines to $25 a share, at which point you purchase 100 shares to replace those you borrowed, netting $2,500. https://www.schwab.com/learn/story/ins-and-outs-short-selling Last accessed June 12, 2021

[382] a profit made by a corporate insider who purchases stock and sells it or sells stock and purchases it within a prescribed period (six months). For example, if an officer buys 100 shares at $5 in January and sells these same shares in February for $6, they would have made a profit of $100. Because the shares were bought and sold within a six-month period, the officer would have to return the $100 to the company under the short-swing profit rule. https://www.investopedia.com/terms/s/shortswingprofitrule.asp,See also https://www.merriam-webster.com/legal/short-swing%20profit last accessed June 12, 2021

[383] Section 223, Companies Ordinance, 1984. *Prohibition of short-selling.* - No director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company, and no person who is directly or indirectly the beneficial owner of not less than ten per cent of the listed equity securities of such company, shall practise directly or indirectly short-selling such securities.
Section 224(1), Companies Ordinance, 1984. *Trading by director, officers and principal shareholders.* - Where any director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company or any person who is directly or indirectly the beneficial owner of more than ten per cent of its listed equity securities makes any gain by the purchase and sale, or the sale and purchase, of any such security, within a period of less than six months, such director, chief executive, managing agent, chief accountant, secretary or auditor or person who is beneficial owner shall make a report and tender the amount of such gain to the company and simultaneously send an intimation to this effect to the registrar and the Commission

[384] Section 224(1)

[385] Proviso Section 224(1), Companies Ordinance, 1984 which states "Provided that nothing in this sub-section shall apply to a security acquired in good faith in satisfaction of debt previously contracted."

[386] Section 224(4), Companies Ordinance, 1984 states; Whoever knowingly and wilfully contravenes or otherwise fails to comply with any provision of section 222, section 223 or section 224 shall be liable to a fine which may extend to thirty thousand rupees and in the case of a continuing contravention, non-compliance or default to a further fine which may extend to one thousand rupees for every day after the first during which such contravention, non-compliance or default continues.

It is quite astonishing that at Listed Companies (Prohibition of Insider Trading) Regulations, 2001 does not treats an 'Associate' as an Insider but fixes criminal liability by imposing penalty in the form of fines while it treats 'connected person' as an Insider and, astonishingly, hold him civilly liable. This is a rigmarole. Paragraph 3 of Guideline prohibit Associates from Insider Trading[387] while Paragraph 4 provides Penal Provision for 'Associate'.[388] On the other hand, Paragraph 5 prohibits Connected Person and fixes Civil Liability of compensation in the form of damages.[389] Now coming to Securities Act, 2015, insider trading has been prohibited categorically for an individual as well as company.[390] Any person who commits insider trading shall be liable in case

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[387] Paragraph 3, Listed Companies (Prohibition of Insider Trading) Guidelines, 2001. Prohibition on dealing, communicating or counseling by insiders.- No person who is or has been, at any time during the preceding six months associated with a company shall:
(i) either on his own behalf or on behalf of any other person, deal in securities of a company listed on a stock exchange on the basis of any unpublished price sensitive information; or
(ii) communicate any unpublished price sensitive information to any person, with or without his request for such information, except as required in the ordinary course of business or under any law; or
(iii) counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information.

[388] Paragraph 4, Listed Companies (Prohibition of Insider Trading) Guidelines, 2001. Violation of provisions relating to insider trading.- A person who deals in securities or communicates any information or counsels any person dealing in securities in contravention of the provisions of paragraph 3 shall be guilty of insider trading and shall be liable to penal action under section 15B of the Ordinance. 15B of SEO has been omitted after amendment in Finance Act, 2008, with 15E of SEO whereby penal provision in the form of fine is inserted i.e., liable to fine, which may extend to ten million rupees or three times the amount of gain made or loss avoided by such person, or loss suffered by another person, whichever amount is higher.

[389] Paragraph 5, Listed Companies (Prohibition of Insider Trading) Guidelines, 2001. Liability.-(1) Every connected person who purchases, sells or otherwise deals in and with securities of an issuer with the knowledge of unpublished price sensitive information with respect to the issuer that has not been generally disclosed is liable to compensate the seller or purchaser of the securities, as the case may be, for damages as a result of the trade unless,
(a) the connected person proves that the person reasonably believed that the unpublished price sensitive information had been generally disclosed; or
(b) the unpublished price sensitive information was known or ought reasonably to have been known to the seller or purchaser, as the case may be.
(2) Every insider who informs another person of unpublished price sensitive information with respect to the issuer that has not been generally disclosed, shall be liable to compensate for damages any person that thereafter sells securities of the issuer to or purchases securities of the issuer from the person that received the Information

[390] Section 128 of the Securities Act, 2015 Pakistan. *Prohibition of insider trading.—*
(1) No person shall indulge in insider trading and any contravention of this section shall be an offence.
(2) Insider trading shall include,
(a) an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals;
(b) any other person to whom inside information has been passed or disclosed by an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals;

of an individual to imprisonment to the term of three years or a fine of two hundred million and in the case of company, three hundred million rupees fine.[391]

Insider trading is exceedingly expensive in terms of enforcement, and only a small percentage of offenders are brought to justice or found guilty in court. First off, white-collar criminals are treated quite leniently by the criminal justice system. The white-collar criminal obtains protection primarily due to their social standing due to some technical factors, political connections, and financial connections. Second, corporations perpetrate a large number of white-collar crimes. There hasn't yet been a successful way to prosecute businesses under criminal law. Few organizations or individuals have been brought to justice under the criminal and civil laws due to the lack of an effective implementation mechanism for corporate crimes. Well, international capital market history, is otherwise littered with precedents where rich, affluent and eminent stock market players/business tycoons were convicted and sentenced by courts with quite regularity for ripping off investors, besides being slapped hefty penalties, for their involvement a wide range of capital market manipulations and frauds but when it comes to Regulator and Judiciary of Pakistan, the scenario changes.

(c) transaction by any person as specified in clauses (a) and (b) or any other person who knows or ought to have known under normal and reasonable circumstances, that the information possessed and used for transacting any deal is inside information; or
(d) an insider person passing on inside information to any other person, or suggesting or recommending to another person to engage in or dealing in such listed securities with or without the inside information being disclosed to the person who has dealt in such securities.
(3) The following shall not be deemed as insider trading:
(a) any transaction performed under an agreement that was concluded before the time of gaining access to inside information; or
(b) the disclosure of inside information by an insider person as required under law. (4) No contract shall be void or unenforceable by reason only of an offence under this section.

[391] Section 159 of the Securities Act, 2015 Pakistan. *Offences and penalties*.—(1) Any person who commits an offence under section 128 (insider trading) shall be liable—
(a) in the case of an individual, to imprisonment of either description for a term which may extend to three years or to a fine which may extend to two hundred million rupees or three times the amount of gain made or loss avoided by such person, or loss suffered by another person, whichever amount is higher; and
(b) in the case of a company, to a fine which may extend to three hundred million rupees or three times the amount of gain made or loss avoided by such company, or loss suffered by another person, whichever amount is higher.

3.8 Role of Regulator and Judiciary to curb Insider Trading

Since evolution of legislation in Pakistan regarding curbing of Insider trading, several cases arose as whistleblowers. There are number of cases but some are significant being in limelight like Pakistan Kuwait Investment Company, (JS Group) Jahangir Siddiqui Group [392] and Capital Management Company[393]. These were investigated and the culprits were penalized by SECP in recent years. These facts and figures compelled an up-gradation in the existing system to cater the issue. For Example, Pakistan Kuwait Investment Company (PKIC) was fined Rs 0.536 million for insider trading in shares of Fauji Fertilizer Company Limited (FFC)[394].

Jehangir Siddiqui Bank Limited (JSBL) and Jehangir Siddiqui Group of Companies (JS Group) has committed insider trading in collusion with officials of SBP officials.[395] Despite confirmation from the Securities and Exchange Commission of Pakistan (SECP) of illegal insider trading by JSBL in the shares of Azgard Nine Limited resulting in price manipulation of shares, the SBP has taken no action against the accused bank for breaking SBP banking regulations.[396] Quoting instances of when JSBL sold shares of Azgard Nine Limited at inflated prices to its sister JS Group concerns in July 2007 and April 2008, as a result Azgard shares of JS Group in Agritech Limited,

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[392] https://newsrecorder100.wordpress.com/2013/07/12/the-biggest-stock-market-fraud-committed-by-jahangir-siddiqui/ last visited on 22.08.2022

[393] Before the Executive Director (Securities Market Division) in the matter of Show Cause Notice No. SCD-SD (Enf)/khi/dcml/2013/061 dated March22, 2013 issued to M/S Dawood Capital, pdf available at http://www.secp.gov.pk/orders/pdf/Orders_2013/19_Order_SCN-DCML.pdf (Last Accessed May 6 , 2021.)

[394] PKIC through CEO v. SECP (2017 CLD 443 SECP)

[395] Transparency International Pakistan (TIP) in a letter to Governor of the State Bank of Pakistan (SBP) Yaseen Anwar, May 2013 may be accessed on https://tribune.com.pk/story/549031/share-prices-state-bank-asked-to-take-action-against-js-bank last accessed on 22.08.2022

[396] Ibid. As per letter of Transparency International, SECP has confirmed that allegations (against JSBL) are correct, and has started taking action against the individuals and companies involved in this illegal act, filing criminal cases in a court of law in April 2013. Yet, the SBP, which should have initiated action against JSBL in 2009, is still sitting on this illegal act.

were sold at double the market price to the National Bank of Pakistan in October 2012, causing a loss of Rs1.75 billion to national exchequer.[397]

Another notable case related to insider trading in Pakistan is the Aqeel Karim Dhedhi, the famous 'AKD' case.[398] AKD, a prominent stockbroker, was charged with insider trading by the SECP in 2014. The case involved allegations that AKD and his associates engaged in trading shares of a SSGPL company having 'say' in OGRA by increasing the gas tariffs, based on material non-public information, thereby making substantial profits.[399] Astonishingly, Sindh High Court ruled decision in his favor because NAB couldn't provide sufficient evidence regarding happening of Insider Trading. Moreover, it was stated by the court that SECP is the right forum to take action and file reference instead of NAB being matter of stock exchange.[400]

In *Muhammad Hanif Abbasi Vs. Jahangir Khan Tareen and others (United Sugar Mills Case)*[401] Securities and Exchange Commission of Pakistan accused Jahangir Khan Tareen of the offences of insider trading. He was charged of 'lacking fiduciary behavior as a Director' under the Companies Ordinance, 1984[402] and 'insider trading' under Securities Exchange Ordinance, 1969.[403] But, it was quite embarrassing that Jahangir Khan Tareen could not be convicted or sentenced because he had made good his escape by paying an amount of Rs 73,067,000 (over Rs 73 million inclusive of fine imposed and his illegal gains) by Voluntary Return to the Securities and Exchange Commission of Pakistan (SECP) for violating the securities law. The same was asked by Supreme

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[397] JSBL v. SECP (2016 CLD 2045 SECP)

[398] AKD Securities Limited v. SECP (2019 CLD 583 Sindh HC)

[399] https://herald.dawn.com/news/1153528 last accessed on 26.08.2022

[400] https://tribune.com.pk/story/709509/nabs-plea-shc-rules-in-favour-of-aqeel-dhedhi last accessed 27.08.2022

[401] Muhammad Hanif Abbasi v. Jehangir Khan Tareen and others, C.P No.36 of 2016 under Article 184(3) of Constitution of Islamic Republic of Pakistan. (2018 PLD 114 SC)

[402] Section 217 of Companies Ordinance, 1984. *Declaring a director to be lacking fiduciary behavior.*- The Court may declare a director to be lacking fiduciary behavior if he contravenes the provisions of section 214 or sub-section (1) of section 215 or section 216.

[403] Section 15-A & 15-B[erstwhile] of the Securities Exchange Ordinance, 1969.

court of Pakistan in above captioned case that why SECP didn't proceed against Jahangir Tareen more strictly after he had admitted violating corporate law and commission of corporate crime. This case comes under the umbrella of Classical Theory (Fiduciary Duty Theory) whereby Jahangir Khan Tareen, being a Director of JDW Sugar Mills Ltd. was aware of the fact that the said company is going to purchase majority shares and he thereby takeover United Sugar Mills Ltd. (USML) and made a gain of Rs.70.811 million by selling USML shares after its takeover by JDW Sugar Mills Ltd. through public offer. It fulfills all ingredients of Classical theory, i.e., Under the Classical Theory of insider trading, a person in possession of material, non-public information has a duty to abstain from trading, or disclose the information before trading, if such person has a fiduciary relationship with the shareholders.

As far as role of SECP to curb Insider Trading is concerned, it is imperative to note that in March 2017, the SECP had issued 24 show-cause notices to the brokers involved in insider trading in the Pakistan Stock Exchange.[404] In that year, the index increased by 9,000 points in a single day and again by 3,000 points the following day, according to SECP, which claimed that this was anomalous behaviour in the capital market. In order to prevent any possibility of unlawful trading, the SECP began to analyse the situation and launch an inquiry to find any anomalies in the capital market. A leading bank employee was accused of insider trading by the SECP in a criminal complaint that was also filed in March 2017.[405] Syed Misbah Uddin Rizvi, the principal accuser, was the head of equity and capital markets at BOP (Bank of Punjab) and was in charge of placing orders for equity investments and disinvestments on the bank's behalf. The matter was brought before the session's judge in Karachi and in the result of an inquiry, the SECP found that he had

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[404] SECP, Press Release March 29, 2017 https://www.secp.gov.pk/media-center/press-releases/ last accessed August 27, 2022

[405] Din Capital Limited v. Commissioner SECP (2020 CLD 1483 SECP)

inside information regarding the bank's decisions to invest/disinvest as defined in Section 130 (g)[406] and Section of 129 (d)[407] of the Securities Act, 2015 respectively.[408] The suspect was discovered to have engaged in insider trading with his relatives, Uddin Rizvi, Syed Khalid Grami, and Syed Wajid Grami, in cooperation and connivance. According to the SECP's inquiry, the bank employee actively traded shares, which was also against bank policy, by utilising the inside knowledge.[409]

His illegal trade brought in millions of rupees in profit. The analysis of KATS[410] trading data for the period from August 24, 2012, to February 2, 2016 (the review period), obtained from the Pakistan Stock Exchange, revealed that Syed Khalid Grami (Khalid) and Syed Wajid Grami engaged in a number of suspicious transactions involving the bank on various dates for their own financial gain. In violation of Section 128 (1) of the Securities Act of 2015,[411] Syed Misbah

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[406] 129. Inside information.—For the purposes of this Part the expression "inside information" means (g) any person obtaining inside information as part of his employment or when discharging his usual duties in an official capacity or in any other way relating to work performed under contract of employment or otherwise;
[407] 129. Inside information.—For the purposes of this Part the expression "inside information" means—
(d) information regarding decision or intentions of a person to transact any trade in listed securities.
[408] SECP, Press Release March 29, 2017 https://www.secp.gov.pk/media-center/press-releases/ last accessed August 27, 2022
[409] Regulation G-2, SBP Employees' Prudential Regulations, 2015
[410] KATS is Karachi Automated Trading System which facilitates trading for stock brokers
[411] Section 128 of Securities Act, 2015 stat3es: 128. Prohibition of insider trading.—
(1) No person shall indulge in insider trading and any contravention of this section shall be an offence.
(2) Insider trading shall include,
(a) an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals;
(b) any other person to whom inside information has been passed or disclosed by an insider person transacting any deal, directly or indirectly, using inside information involving listed securities to which the inside information pertains or using others to transact such deals;
(c) transaction by any person as specified in clauses (a) and (b) or any other person who knows or ought to have known under normal and reasonable circumstances, that the information possessed and used for transacting any deal is inside information; or
(d) an insider person passing on inside information to any other person, or suggesting or recommending to another person to engage in or dealing in such listed securities with or without the inside information being disclosed to the person who has dealt in such securities.
(3) The following shall not be deemed as insider trading:
(a) any transaction performed under an agreement that was concluded before the time of gaining access to inside information; or
(b) the disclosure of inside information by an insider person as required under law. (4) No contract shall be void or unenforceable by reason only of an offence under this

executed a number of transactions in various scrips in connection with trading activities of the bank. The SECP has also raised the issue of bank workers engaging in insider trading with the State Bank of Pakistan in order to take the proper action and issue directives. In order to stop market abuses and unfair trading practises such front-running and insider trading, which adversely influence this fundamental aspect of the markets, the SECP actively monitors equities trading on the stock market. [412]

PECO (Pakistan Engineering Council) is another example of insider trading in which before the announcement of privatization of PECO, in 2016, Mian Mansha, bought 200 kanal prime location land which he sold as well as soon as the news of privatization made public. Though it was recovered by NAB through plea bargain and the same was not prosecuted in banking court by SECP.

Naturally, SECP is looking into any potential anomalies or manipulation by major brokerage firms in an effort to stop "Insider Trading" and illegal leverage in the stock market. Market surveillance is a continual endeavour to identify market abuses, guarantee fair market practises, and take corrective action as necessary to safeguard the interests of all market players. While incidents of market abuses were also found for further investigation, offsite surveillance during the year led to recommendations of adjudication proceedings for non-disclosure or incorrect disclosure of material information. In order to further investigate the alleged market abuses, onsite investigations were combined with off-site market surveillance. Below are the results of

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section.

[412] Front-running, a form of insider trading arises when a person engaged in processing or making investment decision/order in his official capacity uses that information for his personal benefit directly or indirectly. The basic purpose of front running/insider trading is to take advantage of the price movement caused by the large trading order once it is executed in the market.

occurrences of market manipulation, insider trading, and other market abuse that were observed over the previous five years;

Table 4: Prosecution Status of Insider Trading in Pakistan from year 2018-2022

Year	Investigations completed/in process	Cases referred for criminal prosecution
2022[413]	14	05
2021[414]	Nil	Nil
2020[415]	1	1
2019[416]	2	1
2018[417]	2	1

3.9 Conclusion

Inside information abuse has caused enormous damage to the Pakistani financial market. To curb and curtail, different legal instruments have been promulgated. This chapter provided an overview

[413] SECP Annual Report 2022, issued on 18.11.2022 https://www.secp.gov.pk/document/annual-report-2022/?wpdmdl=46161&refresh=644b1c8ca2a981682644108
[414] SECP Annual Report 2021, issued on 21.05.2022 https://www.secp.gov.pk/document/annual-report-2021/?wpdmdl=44660&refresh=644b1c8cab78e1682644108
[415] SECP Annual Report 2020, issued on 24.12.2020 https://www.secp.gov.pk/document/annual-report-2020/?wpdmdl=41025&refresh=644b1c8cb2ecc1682644108
[416] SECP Annual Report 2019, issued on 28.02.2020 https://www.secp.gov.pk/document/annual-report-2019/?wpdmdl=38692&refresh=644b1c8cb6cee1682644108
[417] SECP Annual Report 2018, issued on 28.09.2018 https://www.secp.gov.pk/document/annual-report-2018/?wpdmdl=32385&refresh=644b1c8cc6c961682644108

of the legislative evolution of insider trading laws in Pakistan. Different enactments and their distinct features were analyzed. The prime issues were discussed like, how the insider trading law has evolved in Pakistan? How different enactments contributed to the present legal framework? The main focused laws were Securities Exchange Ordinance, 1969, Listed Companies (Prohibition of Insider Trading) Guidelines, 2001 and Securities Act, 2015 as all these laws directly deal with the insider dealing prohibition and sanctions. The main objective was to explore the varying approaches and tools utilized by the state to curb market manipulation by inside information abuse. In the wake of many stock market crashes, SEO 1969 was promulgated in order to control the inside information abuse while Securities Act was enacted to streamline the legal regime and bring a restructured code to control market manipulation. However, it is concluded with heavy heart that both subject legislations lack the international standards and end up being toothless legislative devices to curtail the menace. One of Main reason of failure is 'person connected approach', instead of 'information connection approach', while defining Insider trading. There are two approaches to the defining of the term "insider.' These are the "person connection" approach and the "information connection" approach. The "person connection approach" defines an insider as someone who has a relationship (direct or indirect) with the issuer of the securities Insider trading, under this approach, is considered inconsistent with a fiduciary or similar duty owed to the entity whose securities are traded or which is the owner of the inside information.

In the light of issues faced while conducting research, the term of "Connected Person" may also be included in the Securities Act, 2015 to entirely classify the insider trading in order to assimilate and clarifying of vagueness of terms 'associate', 'connected person' and 'person deemed to be connected' for the purpose of incriminating the insider. An examination of these definitions leaves the impression that the law has either been drafted in a hurry through "patch work" or the

Guidelines that were adopted 5 years later were borrowed from some other law, possibly the law of India. When the "associated person" is the same as the "connected person," Why was the need felt to retain the definition of the "associated person" is not very clear. Due to this reason, the meaning of insider does not include the concept of "associated person." Resultantly, insider trading law in Pakistan doesn't outlaw explicitly the associated person from Insider Trading but it holds liable criminally.

The legislation against insider trading is also poorly understood in Pakistan, despite the widespread debate in the rest of the globe, and it occasionally seems as though insider trading and market manipulation are being conflated. Therefore, it is necessary to explain Pakistani law in the context of global changes so that Pakistan can adopt what is seen as good practise on a global scale. The watchdog is currently dealing with several important instances of insider information abuse, which could serve as the impetus for new legislation to solve current substantial issues and eliminate ambiguity in insider trading regulations. The Securities Act of 2015 must be enforced in a proper legal framework to prevent insider trading, increase financial equity, and make corporate areas simple after connection with international legal prescribed procedures.

CHAPTER FOUR

ENFORCEMENT OF INSIDER TRADING LAWS IN USA & CHINA: AN EMPERICAL PERSPECTIVE

4.1 Introduction

In this chapter, development and enforcement mechanism of insider trading legislation in the US and other developed economies especially China (the upcoming biggest economic giant) has been examined from an empirical and comparative perspective. It is pertinent to mention that Making laws and regulations is the first step for a country to restrict insider trading. The United States of America, which is governed by the Securities and Exchange Commission in accordance with the requirements of the Securities Exchange Act of 1934, is considered to be the most developed and one of the first nations to enact rules against insider trading. The enactment of the Sarbanes-Oxley Act, [418] the major change [419] to the U.S. securities regulations since the New Deal era, [420] demonstrates the growing emphasis on corporate accountability and standards of conduct. The US is devoting greater resources to ensuring that the laws prohibiting abusive behaviours like insider trading are effectively enforced. Naturally, adequate staff, funding, and technical surveillance equipment are necessary for effective resource distribution. Agendas could also include instructional or enlightenment objectives in order to emphasize the importance of these statutory tasks to the relevant constituencies, including company insiders, bankers, brokers, courts, lawmakers, and the investing public.

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[418] Sarbanes-OxleyAct of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). See generally HAROLDS. BLOOMENTHAL, SARBANES-OXLEY ACT IN PERSPECTIVE (2002); JAMES HAMILTON & TED TRAUTMANN, SARBANES-OXLEY ACT OF 2002: LAW AND EXPLANATION (2002).
[419] John T. Bostelman et al., Enactment of Broad Accounting, Corporate Governance Reform Act Brings New Prohibitions, Requirements for Executives and Auditors, 34 Sec. Reg. & L. Rep. (BNA) 1281 (2002).
[420] Securities Act of 1933, 15 U.S.C. § 77 (2000); Securities Exchange Act of 1934, 15 U.S.C. § 78 (2000)

As far as China is concerned, in recent years, it has considerably increased its efforts to combat insider trading. Although the Chinese insider trading law is primarily borrowed from other countries, its application has shown unique characteristics in the region. The degree of insider trading enforcement in China appears to be at a level equivalent to the relevant jurisdictions outside based on the nature, scope, and frequency of the punishments levied. Comparing the enforcement pattern and intensity level in China with other jurisdictions, the enforcement of China's insider trading law has been carried out by the regulator and criminal courts in practice. It is intended to accomplish three main goals, which are to measure the intensity of insider trading enforcement, generate descriptive statistics on the characteristics of handled insider trading cases, and identify and analyze potential factors that could affect the penalties in administrative and criminal proceedings.

Since this chapter is focused towards the development of insider trading laws in US & China, therefore, it is imperative to discuss the enforcement mechanism of US & Chinese Laws, regulations and court interference to curb Insider trading. It is widely known by the public, the courts, and market participants that insider trading and other unlawful acts[421] are frequent in the United States. Because of this, American culture often supports very rigorous prosecution of criminal violations, unlike many other countries. The courts assist in this process by maintaining convictions for insider trading based on circumstantial evidence[422] and (in accordance with the federal sentencing guidelines)[423] imposing substantial jail terms where warranted. As a result,

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[421] Such offenses include stock manipulation, parking of securities, and "scalping."
[422] SEC v. Sargent, 229 F.3d 68, 75 (1st Cir. 2000)
[423] Nasser, supra note 158, at 388-93.

compared to other countries, U.S. enforcement in this case is reasonably effective, which promotes both market integrity and law compliance. [424]

4.2 Development of Insider Trading Laws in US & Chinese Legal Regimes

America has unquestionably led the globe in terms of insider trading legislation. In Strong v. Repide, [425] the U.S. Court held that it would be misleading to keep buyers unaware of a company executive's regular actions while selling his own shares because this executive could affect the value of his company's shares. Although this was the most important development in the creation of insider trading law, formal regulation did not begin until the passage of the Securities Act of 1933. Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934 in response to the 1929 stock market crash in an effort to rein in the excesses that were seen to have contributed to the crash. [426] The two Acts were designed to increase financial specialists' understanding while imposing a responsibility for due diligence on those who create records that contain essentially just the most basic information about a security. Securities Exchange Act 1934 gave the SEC power over voluntary trading in securities while Securities Act, 1933 regulates the issuance and enrolment of securities. [427]

The United States' convention of custom-based law has allowed the courts to develop a significant portion of the law there.[428] The principal source of regulation in this field is federal law. [429] Even

[424] Steinberg, Marc I., The International Lawyer Vol. 37, No. 1, SYMPOSIUM: INTERNATIONAL COMPANY AND SECURITIES LAW (SPRING 2003), pp. 153-171 https://www.jstor.org/stable/i40031189 last accessed on 14.10.2022

[425] Strong v. Repide, 213 U.S. 419 (1909) was an insider trading case emerging from the closeout of stock in the Philippine Sugar Est. Dev. Co. to an executive of the organization. The respondent, while arranging the buy of the offended party's stock, was at the same time arranging the clearance of the corporate land resources for the Philippine government.

[426] L. Loss and J. Seligman, (1995), Fundamentals of Securities Regulation, 3''' edn, (Boston: Little, Brown and Company).

[427] L. Loss and J. Seligman, (1995), Fundamentals of Securities Regulation, 3''' edn, (Boston: Little, Brown and Company).

[428] (Newkirk, 1998).

[429] WANG & STEINBERG, supra note 4.

though certain states, including New York, permit derivative lawsuits against accused inside traders based on unjust enrichment[430] and perceived injury to the corporation, state law is often unavailable in this case. [431] Along with the Department of Justice, the SEC develops and enforces the regulations that govern the securities market. The SEC is the most active financial regulatory body in the world when it comes to prosecuting insider trading cases and upholding the law. The Securities Exchange Commission (SEC) oversees the US securities market. The New York Stock Exchange and NASDAQ are the two most important stock market exchanges in the global indices based on market capitalization. According to market capitalization,[432] the US holds the top spot internationally[433] which may be seen in the following table. As far as Pakistan is concerned, it has 375 companies listed on PSX with a total market capitalization of just $32Billion, standing at 56 number in the world market.

Table 5: Rank of Countries by Market Capitalization: Data of 2013[434]

Countries	Market Cap (Trillions)	Rank
United States	18.682	1
China	3.412	2
Japan	3.325	3
United Kingdom	3.266	4
France	2.930	5

[430] Diamond v. Oreamuno, 248 N.E.2d 910,912 (N.Y. 1969).
[431] Freeman v. Decio, 584 F.2d 186, 187-96 (7th Cir. 1978) (applying Indiana law); Schein v. Chasen, 313 So.2d 739, 746 (Fla. 1975); WANG & STEINBERG, supra note 4, § 16.1, at 1106 ("State law is rarely applied to stock market insider trading.").
[432] Market Capitalization= share price * Total number of outstanding shares
[433] International Journal of Accounting and Financial Reporting ISSN 2162-3082 2013, Vol. 3, No. 1, p.3 https://www.macrothink.org/journal/index.php/ijafr/article/viewFile/3269/2976 last accessed on 21.08.2022
[434] International Journal of Accounting and Financial Reporting ISSN 2162-3082 2013, Vol. 3, No. 1, p.3 https://www.macrothink.org/journal/index.php/ijafr/article/viewFile/3269/2976 last accessed on 21.08.2022

Table 6: Rank of Countries by Market Capitalization: Data of 2023[435]

Countries	Market Cap (Trillions)	Rank
United States	45.571	1
China	6.142	2
Japan	4.20	3
India	3.265	4
United Kingdom	2.989	5

Since 1990, when China's stock market was still in its very early stages, insider trading has been strictly regulated. Its lack of practical insider trading penalties, however, made this regulation mostly symbolic and more akin to a political statement than a legitimate law. Shanghai and Shenzhen Stock Exchanges are two notable stock exchanges in China. When it comes to global market capitalization, China comes in second. The CSRC oversees the Chinese securities market.[436] With the introduction of the Establishment of Securities Companies with Foreign Equity Participation Rules in 1993, China first made insider trading illegal. In actuality, "their economy has developed so quickly that they have expected to play catch-up in terms of insider trading regulations." It is in mid of the 1990s, the stock exchanges in Shenzhen and Shanghai have been established. In China, insider trading is thought to be widespread. Insider trading factor can be traced in almost 80% of all securities lawsuits.[437]

[435] https://companiesmarketcap.com/all-countries/ last accessed May 21, 2023

[436] China Securities Regulatory Commission (CSRC) was established in 1992 for this purpose. In 1999, the Chinese Securities Law recognized the CSRC as the sole regulatory agency responsible for regulating securities instruments and markets in China.

[437] Securities and Exchange Commission v. Bonan Huang, et al., Civil Action No. 2:15-cv-00269 (E.D. Pa.)

4.2.1 The United States

4.2.1.1 The Legal Regime governing insider trading in USA

It has depended heavily on the courts to establish the legislation against insider dealing since it is rooted in the common law tradition of England, upon which the US legal system is based. The SEC and the United States Department of Justice have taken the lead in defining the legality of insider trading because Congress has mandated that they safeguard investors and preserve markets free from fraud.[438]

The 1934 Act specifically addressed insider trading in Section 16(b), which forbids corporate insiders from making short-swing profits (profits realized in any period less than six months) on the shares of their own firm, except in extremely specific circumstances.[439] It is intended to prohibit insider trading by individuals most likely to have access to crucial corporate information and only applies to directors, officials, and stockholders who own more than 10% of the company. The Act forbids insider trading indirectly through Section 10(b), which makes it unlawful for anyone to use or employ any manipulative or deceptive device or contrivance in connection with

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[438] Thomas C. Newkirk, Insider Trading –A U.S. Perspective, 16th International Symposium on Economic Crime Jesus College, Cambridge, England, September 19, 1998, https://www.sec.gov/news/speech/speecharchive/1998/spch221.htm last accessed on 10.10.2022

[439] Section 16(b), Securities and Exchange Act of 1934 states (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) or a security-based swap agreement involving any such equity security within any period of less than six months, unless such security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security or security-based swap agreement purchased or of not repurchasing the security or security-based swap agreement sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same there- after; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security-based swap agreement or a security-based swap involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

the purchase or sale of any security listed on a national securities exchange or any security not so listed in violation of such rules and regulations as the [SEC] may prescribe.[440] The SEC adopted

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[440] Section 10(b), Securities and Exchange Act of 1934 states SEC. 10B. POSITION LIMITS AND POSITION ACCOUNTABILITY FOR SECURITY-BASED SWAPS AND LARGE TRADER REPORT- ING.
(a) POSITION LIMITS.—As a means reasonably designed to pre- vent fraud and manipulation, the Commission shall, by rule or reg- ulation, as necessary or appropriate in the public interest or for the protection of investors, establish limits (including related hedge ex- emption provisions) on the size of positions in any security-based swap that may be held by any person. In establishing such limits, the Commission may require any person to aggregate positions in—
(1) any security-based swap and any security or loan or group of securities or loans on which such security-based swap is based, which such security-based swap references, or to which such security-based swap is related as described in para- graph (68) of section 3(a), and any other instrument relating to such security or loan or group or index of securities or loans;
or
(2) any security-based swap and—
(A) any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of such security-based swap as described in paragraph (68) of section 3(a); and
(B) any other instrument relating to the same security or group or index of securities described under subparagraph (A).
(b) EXEMPTIONS.—The Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person or class of persons, any security-based swap or class of security-based swaps, or any transaction or class of transactions from any requirement the Commission may establish under this section with respect to position limits.
(c)SRORULES.—
(1) IN GENERAL.—As a means reasonably designed to pre-
vent fraud or manipulation, the Commission, by rule, regula- tion, or order, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title, may direct a self-regulatory organization—
(A) to adopt rules regarding the size of positions in any security-based swap that may be held by—
(i) any member of such self-regulatory organization; or
(ii) any person for whom a member of such self- regulatory organization effects transactions in such security-based swap; and
(B) to adopt rules reasonably designed to ensure compliance with requirements prescribed by the Commission under this subsection.
(2) REQUIREMENT TO AGGREGATE POSITIONS.—In establishing the limits under paragraph (1), the self-regulatory organization may require such member or person to aggregate positions in—
(A) any security-based swap and any security or loan or group or narrow-based security index of securities or loans on which such security-based swap is based, which such security- based swap references, or to which such security-based swap is related as described in section 3(a)(68), and any other instrument relating to such security or loan or group or narrow-based security index of securities or loans; or
(B)(i) any security-based swap; and ii) any security-based swap and any other instrument relating to the same security or group or narrow-based security index of securities.
(d) LARGE TRADER REPORTING.—The Commission, by rule or regulation, may require any person that effects transactions for such person's own account or the account of others in any securities-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans as set forth in paragraphs (1) and (2) of subsection (a) under this section to report such information as the Commission may pre-scribe regarding any position or positions in any security-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans and any other instrument relating to such security or loan or group or narrow-based security index of securities or loans as set forth in para- graphs (1) and (2) of subsection (a) under this section.
(June 6, 1934, ch. 404, title I, Sec. 10B, as added Pub. L. 111-203, title VII, Sec. 763(h), July 21, 2010, 124 Stat. 1778.)

Rule 10b-5[441] to implement Section 10(b), which makes it illegal for anyone to use any method, directly or indirectly, through an inaccurate statement in order to fraudulently buy or sell shares. It is forbidden to commit fraud or deceit in connection with the acquisition or disposal of securities under these extensive anti-fraud laws.[442] The corporate insider who secretly traded in his own company's stock while in possession of inside information fell within the classic definitions of fraud, making the anti-fraud rules very simple to apply.

The question of whether Section 10(b) and Rule 10b-5 forbade insider trading by corporate "outsiders" was less obvious. Since the ibid Sections do not specifically address insider trading, it is in this area that the courts have used their discretion to make the most significant advancements in American insider trading legislation. The Securities and Exchange Commission gave the aforementioned legal provisions a broad interpretation in the 1961 case of In re Cady Roberts & Co.[443] The Commission determined that an outsider could be subject to the same duties or obligations as a corporate insider.[444] The Commission determined that a broker(Cady Robert) who traded while in possession of nonpublic information related to Curtis-wright corporation that he acquired from a company director (J. Cowdin, who is also an associate at Cady Robert

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[441] 17 CFR § 240
Rule 10b-5, Securities Rules states Employment of manipulative and deceptive devices.
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
(a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

[442] Section 17(a) of the Securities Act of 1933 reaches similar fraud in the initial offering or sale of a security.

[443] 40 SEC 907 (1961) In Re Cady Roberts & Co.

[444] Ibid. The Commission reasoned in language worth quoting: "Analytically, the obligation [not to engage in insider trading] rests on two principal elements: first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing. In considering these elements under the broad language of the anti-fraud provisions we are not to be circumscribed by fine distinctions and rigid classifications. Thus, it is our task here to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities. Intimacy demands restraint lest the uninformed be exploited"

brokerage) violated Rule 10b-5 based on this justification. The "disclose or abstain rule" was established by the Commission, which requires insiders and outsiders ("temporary" or "constructive" insiders) who have material nonpublic information to either disclose it before trading or refrain from trading until the information is made widely available. [445] This is also known as 'Parity of Information' Rule.

A federal circuit court backed the Commission's decision in Cady some years later in the case of SEC v. Texas Gulf Sulphur Co., noting that anyone in possession of inside knowledge is compelled to either disclose the information publicly or stop from trading. [446] No one should be permitted to trade with the advantage of inside knowledge, according to the court, because doing so defrauds all other buyers and sellers in the market. [447] This is the widest notion of illegal insider trading so far.

In terms of economic history, the 1980s were a remarkable decade that saw an unprecedented number of company mergers and takeovers. Insider trading increased significantly as well. Interestingly, courts curtailed the scope of Section 10(b) and Rule 10b-5 in the context of insider trading at this time. In Chiarella v. United States, the US Supreme Court overturned the financial printer's criminal conviction for illegally obtaining information about tender offers and a merger from documents he was contracted to print and investing in the companies that employed him by buying stock in them.[448] The Supreme Court granted cert & overturned the conviction on the grounds that trading on relevant nonpublic information alone was insufficient to bring about

[445] If we see the Dirk Case Footnote 14, Justice Powell formulated the concept of the "constructive insiders" – outside lawyers, consultants, investment bankers or others – who legitimately receive confidential information from a corporation in the course of providing services to the corporation. These constructive insiders acquire the fiduciary duties of the true insider, provided the corporation expected the constructive insider to keep the information confidential.

[446] 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969)

[447] Id. at 851-52.

[448] 445 U.S. 222 (1980).

accountability under the anti-fraud rules, and that the printer did not deceive the target shareholders because he owed them no duty (i.e., no fiduciary duty to shareholder).

In response to the *Chiarella* decision, the Securities and Exchange Commission promulgated Rule 14e-3[449] under Section 14(e) of the Exchange Act, in 1980, and made it illegal for **anyone** to trade on the basis of material nonpublic information regarding **tender offers** if they knew the information emanated from an insider.[450] The rule's aim was to eliminate the Chiarella duty obligation in tender offer situations, which were the most lucrative and disruptive for insider trading.

A person who has no fiduciary relationship to an issuer may still be liable under Rule 10b-5 for trading in the issuer's securities while in possession of information obtained in violation of a relationship of trust and confidence, according to the Second Circuit is adoption of the "misappropriation" theory in 1981. This decision was made in the case of United States v. Newman.[451] Securities trader Newman used substantial nonpublic information regarding business takeovers that he acquired from two investment bankers who had stolen it from their workplaces to inform his trading decisions.[452] Second circuit wanted to check whether gift test was met.

In the case of Dirks v. SEC,[453] which was decided three years later, the Supreme Court overturned the SEC's censure of a securities analyst who informed his clients of an alleged deception by an issuer(one of the director at EFA) he had learned about firsthand before making the information

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[449] 17 CFR § 240.14e-3 - Transactions in securities on the basis of material, nonpublic information in the context of tender offers

[450] The Commission's authority to promulgate rules under Section 14(e) of the Exchange Act is confined to the tender offer context. It reads, in relevant part: "It shall be unlawful for any person . . . to engage in any fraudulent, deceptive or manipulative acts or practices, in connection with any tender offer . . . . The [SEC] shall . . . by rule or regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive or manipulative." 15 U.S.C. §78n(e).

[451] 773 F.3d 438 (2014)

[452] 664 F.2d 12 (2d Cir. 1981), aff'd after remand, 722 F.2d 729 (2d Cir. 1983), cert. denied, 464 U.S. 863 (1983).

[453] 463 U.S. 646 (1983).

public. Because Dirks addressed the problem of the "tippees'" trading liability—those who receive information from the insider tipper—it was important. According to Dirks, tippees are responsible if they were aware or reasonably should have known that the tipper had violated a fiduciary obligation by exposing the private information and the tipper gained a direct or indirect personal advantage as a result of the disclosure. In Dirks, the original informant was exempt from liability since he supplied the information with the intention of exposing a deception, not for personal gain. In the 1986 decision of United States v. Carpenter,[454] the Second Circuit discussed the misappropriation theory once more. The Wall Street Journal columnist at the core of the case frequently had an impact on the stock prices of the firms he wrote about. The writer shared in the profits the broker gained by trading ahead of publication after providing the broker with information about his upcoming columns, among others.[455] The Second Circuit rejected the defendants' argument that the misappropriation theory only applies when the information is misappropriated by corporate or constructive insiders, holding "[T]he misappropriation theory more broadly prohibits the trading by insiders' or others of material non-public information in connection with the purchase or sale of securities under Rule 10b-5 and mail and wire fraud."[456] The Supreme Court heard an appeal in the matter. Although the Supreme Court was evenly split on whether Carpenter committed securities fraud, it was unanimous that he committed fraud.[457] However, the Court cited a previous New York decision that stated: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or

[454] 791 F.2d 1024 (2d Cir. 1986), aff'd 484 U.S. 19 (1987).
[455] Echoing the Carpenter case, German prosecutors reportedly are considering bringing insider trading charges against a German television journalist, known as "Germany's first international stock market guru," for allegedly telling his friends which stock he was going to recommend on his weekly program. German TV Journalist is Accused of Insider Trading, AP Worldstream, August 17, 1998, financial pages.
[456] 791 F.2d at 1029.
[457] 484 U.S. 19, 24 (1987).

information for his own personal benefit but must account to his principle for any profits derived therefrom." The Court unanimously upheld the convictions for mail and wire fraud. [458]

The Insider Trading Sanctions Act of 1984 (the "1984 Act") was passed by Congress in 1984 and among its other provisions was a ban on trading in options and other derivative instruments where trading in the underlying security would have been prohibited.[459] The gap that this clause closes is clear: A business insider or her tipee should not be permitted to trade options instead of the underlying security in order to get around Section 10(b). Given that certain courts had ruled that trades between corporate insiders and options dealers to whom he has no fiduciary obligation are not covered by Section 10(b), it is possible that Congress was aware of the limited applicability of the traditional insider trading theory at the time this section was written.[460] The 1984 Act also suggests that Congress has the ability to extend the 1934 Act's ban on insider trading when necessary.[461]

The committee should include precise language specifying the scope of the restriction against trading on the basis of substantial, nonpublic information to the measure, according to several witnesses who spoke at the parliamentary hearings associated with the enactment of the 1984

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[458] Diamond v. Oreamuno, 248 N.E. 2d 910, 912 (N.Y. 1969).

[459] Pub. L. No. 98-376, 98 Stat. 1264 (1984) (codified in scattered sections of 15 U.S.C.).

[460] See Laventhall v. General Dynamics Corp., 704 F.2d 407, 411-12 (8th Cir.), cert. denied, 464 U.S. 846 (1983).

[461] Amici in support of the Government in *O'Hagan* instead interpreted this amendment to have "generalized the misappropriation theory" under § lO(b) be- cause it imposed a prohibition even though "corporations and their insiders do not owe fiduciary duties to those who own or trade options on corporate securities when those options are issued by others." Brief of Amici Curiae North American Securi- ties Administrators Association, Inc., and Law Professors in Support of Petitioner at17-18, *O'Hagan* (No. 96-842), *available in 1991* WL 86236. This interpretation reads far more into Congress's intent than the text of the 1984 Act appears to permit, and the *O'Hagan.Court* predictably chose not to embroil itself in discussion of the 1984 and 1988 legislation in its interpretation of the 1934 Act.

Act.[462] However, despite the Commission's pleadings, Congress refrained from passing legislation defining insider trading.

The Insider Trading and Securities Fraud Enforcement Act of 1988 (the "1988 Act") was passed by Congress in 1988.[463] A remedy against "[a]ny person who violates any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession of material, nonpublic information" is provided for concurrent traders in the same security under Section 20A of the 1988 Act.[464] However, despite the fact that Congress was aware that the Court had been evenly split on the validity of the misappropriation theory in Carpenter, nowhere does the language of Section 20A expand the provisions of the 1934 Act to prohibit trading while in possession of misappropriated information.

The legislative record does show that in 1988, Congress thought about enacting the misappropriation theory. Some members of Congress acknowledged that the

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[462] See id. at 27, *reprinted in* 1984 U.S.C.C.A.N. at 2299. The SEC opposed any definition of insider trading. See Insider Trading Sanctions and SEC Enforcement Legislation: Hearings on H.R. 559 Before the Subcomm. on Telecomms., Consumer Protection, and Fin. of the House Comm. on Energy and Commerce, 98th Cong. 99 (1983) (letter from SEC Chairman John S. R. Shad to Subcomm. Chairman Rep. Timothy E. Wirth) ("Any definition would incorporate new terms and concepts which would have to be interpreted in subsequent litigation."); H.R. Rep. No. 98-355, at 32, *reprinted in* 1984 U.S.C.C.A.N. at 2305 (same); see also Note, A Critique of the Insider Trading Sanctions Act of 1984, 71 Va. L. Rev. 455, 472-73 (1985) (noting that "the SEC strongly opposed the inclusion of a definition" in the 1984 Act). The SEC's, and ultimately Congress's, approach was criticized by Milton Freeman, the drafter of Rule l0b-5. Milton V. Freeman, The Insider Trading Sanctions Bill-A Neglected Opportunity, 4 Pace L. Rev. 221 (1984). The House committee consider- ing the legislation ultimately agreed with the Commission:
[T]he Committee believes that the Commission has used its broad rulemaking authority to respond to marketplace developments; that the adoption of a statutory definition could reduce fiexibility; and that any new definition which might be adopted would be likely to create new ambiguities, thereby increasing rather than limiting uncertainty.. . . Finally, the Committee believes that the adoption of a definition {which would inevitably affect to some degree the substantive law) is not necessary to achieve the basic purpose of the bill: to increase the sanctions available under the law as it now exists and as it continues to evolve.H.R. Rep. No. 98-355, at 13-14, *reprinted in* 1984 U.S.C.C.A.N. at 2286-87.

[463] Pub. L. No. 100-704, 102 Stat. 4677 (1988) (codified in scattered sections of 15 U.S.C.).

[464] Id. at sec. 5, § 20A, 102 Stat. at 4680-81 (codified at 15 U.S.C. § 78t-1 (1994)

misappropriation theory was a means by which some courts had achieved the goal of extending insider trading liability beyond the classical theory, which only forbids trading by corporate insiders, temporary insiders, and their tippees. This support for expanding insider trading liability went beyond the classical theory. For instance, the House Committee on Energy and Commerce proposed that Section 10(b) and Rule 10b-5 should apply to security fraud because the misappropriation argument is "unresolved nationally" in the courts."[465] Despite the fact that several lawmakers agreed that a definition was required, Congress did not take any action to add the misappropriation theory or any other definition of criminal trading on the basis of significant, secret information in the 1934 Act. Regarding the decisions made by Congress in 1988 and 1984, one thing is certain: Congress eventually opted to leave Section l0(b) alone.[466]

Whatever Congress's views on Section l0(b) in 1984 and 1988, neither a definition of insider trading nor any convincing judicial guidance could be found as a result of those legislative efforts. Congress' attempts to change the statute in 1984 and 1988 through committee reports were unsuccessful. Section l0(b) cannot be meaningfully changed unless Congress amends the legislation itself; otherwise, the Commission and the courts will continue to ascertain the 1934 Congress's intent.

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[465] H.R. Rep. No. 100-910, at 10 (1988), *reprinted in* 1988 U.S.C.C.A.N. 6043, 6047. 133 Cong. Rec. 16,393 (1987) (statement of Sen. Alfonse D'Amato).

[466] The remedy enacted in 1988 has little connection with the misappropriation the- ory. It is contemporaneous traders, not third parties alleging misappropriation of confidential information, who are entitled to sue under § 20A. Disjuncture between the misappropriation theory and Congress's objective of protecting investors has thus caused a glaring incongruence between the remedy given to market participants in

The misappropriation doctrine was accepted in federal courts during the following nine years.[467] The misappropriation theory[468] was then rejected by two federal circuit courts in 1995 and 1996 on the grounds that it "requires neither misrepresentation nor nondisclosure" and that it "is not moored [in] [section] 10(b]'s requirement that the fraud be "in connection with the purchase or sale of any security." [469]

The Supreme Court clearly embraced the insider trading misappropriation argument in the case of United States v. O'Hagan in 1997, giving the SEC a significant victory.[470] In a prospective tender offer for the common stock of the Pillsbury Company, O'Hagan was a partner in a law firm hired to represent a corporation called Grand Met. After learning about the impending acquisition, O'Hagan started buying options on Pillsbury shares, which he later sold for a profit of almost $4 million. O'Hagan's main defense was that he did not commit fraud by buying Pillsbury stock on the basis of important, nonpublic knowledge because neither he nor his company had any fiduciary obligations to Pillsbury. O'Hagan's claims were rejected by the court, which upheld his conviction. According to the misappropriation approach, the Court decided that O'Hagan violated Rule 10b-5 by engaging in deception in connection with his purchase of Pillsbury options[471] because he misappropriated the price sensitive information for trading on securities in breach of duty owed to the "source of information"[472] The Court cited two distinct defenses for outlawing insider trading

[467] See, e.g., SEC v. Materia, 745 F.2d 197, 201 (2d Cir. 1984); Rothberg v. Rosenbloom, 771 F.2d 818 (3d Cir. 1985); SEC v. Cherif, 933 F.2d 403 (7th Cir. 1990); SEC v. Clark, 915 F.2d 439 (9th Cir. 1990).

[468] United States v. Bryan, 58 F.3d 933, 944 (4th Cir. 1995); United States v. O'Hagan, 92 F.3d 612 (8th Cir. 1996).

[469] United States v. O'Hagan, 117 S.Ct. 2199, 2211 (1997) (quoting the Eighth Circuit's opinion in O'Hagan, 92 F.3d at 618).

[470] 117 S. Ct. 2199 (1997).

[471] The Court also rejected O'Hagan's argument that the Commission's Rule 14e-3, which prohibits trading in securities based on nonpublic information about a tender offer, is invalid because the Commission exceeded its statutory authority in promulgating it.

[472] 117 S. Ct. at 2207. In the Court's words:The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of the information. In lieu

throughout its judgment. First, the Court emphasized that the purpose of forbidding insider trading is to ensure fair securities markets, which will increase investor trust.[473] The Court also recognised the "information as property" theory that underlies the restrictions on insider trading[474]. The O'Hagan case is a key milestone in establishing the extent of Rule 10b-5 insider trading restrictions, even though insider trading legislation in the United States is still developing.

4.2.1.2 Definition of Insider Trading

The U.S. Securities and Exchange Commission (SEC) defines illegal insider trading as:

> *"The buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material,[475] non-public information[476] about the security".[477]*

The word "insider trading" has many different meanings and connotations, and it refers to both legitimate and illegal activities. Every day, business insiders—officers, directors, or employees—purchase or sell stock in their own companies while abiding by company policy and the rules governing such trading. This is known as insider trading. The kind of insider trading we are talking about here is the illegal kind that most people associate with the term; it is the kind that

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of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.

[473] . . . well-tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence. Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law. An investor's informational disadvantage vis-à-vis a mis-appropriator with material, nonpublic information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill

[474] 117 S. Ct. at 2208.A company's confidential information . . .qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information in violation of a fiduciary duty . . . constitutes fraud akin to embezzlement – the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another.

[475] Material information is any information that could substantially impact an investor's decision to buy or sell the security.

[476] Non-public information is information that is not legally available to the public.

[477] U.S. Securities and Exchange Commission. "Insider Tradinghttps://www.investor.gov/introduction-investing/investing-basics/glossary/insider-trading

gained widespread notoriety in the 1980s thanks to civil lawsuits brought by the SEC and criminal prosecutions brought by the US Department of Justice against Michael Milken and Ivan Boesky, and it even served as the inspiration for the Hollywood fantasy "Wall Street." It is the trading that occurs when those with special access to private knowledge about significant events take advantage of that information to make money or avoid losses on the stock market, to the detriment of the information's source and to regular investors who buy or sell their stock without the benefit of "inside" knowledge.

The attempt of the SEC to keep a fair marketplace exists at the root of the legality issue. A person having insider information would have an unfair advantage over other investors because they would not have the same access and they might be able to generate unfairly higher profits than their fellow investors. Insider trading is when a person engages in a transaction while still being an insider (as defined by the SEC). It also involves sharing important, non-public information before it becomes known to the general public. Consider a scenario in which you are employed by XYZ Company and discover that it is set to announce losses in its quarterly report, which could have an impact on investors. When a friend who has stock in the company hears about it, they sell their shares a few days before the report is out, and the stock price falls immediately afterward. Despite the fact that neither of you meets the criteria of a "insider," you and your companion may have engaged in insider trading. When other investors lacked the information, you took action based on that information.

Due to the notion that it is unfair to the typical investor, the word "insider trading" often carries a negative connotation. Insider trading essentially refers to the trading of shares in a publicly traded firm by a person who has access to substantial, nonpublic information about that stock. The appropriate reporting of an insider's trade qualifies it as an insider transaction, which is

permissible. Insider trading is prohibited. When material knowledge is still secret, insider trading is prohibited and carries severe penalties, including the possibility of fines and jail time. Any non-public information that has the potential to materially affect a company's stock price is referred to as material non-public information. In the stock market, legal insider trades frequently take place. The attempt of the SEC to keep a fair marketplace exists at the root of the legality issue. Insider trading in company stock is acceptable as long as the trades are timely reported to the SEC.

4.2.1.3 Mechanism to contain Insider Trading

The prohibitions against insider trading under the American system are not codified by any statute. Actually, the key players are the SEC and the federal courts. Prior to the U.S. Supreme Court releasing its decisions in the 1980s, lower courts[478] adopted the parity of information[479] and equal access doctrines when interpreting the "disclose or abstain" requirement of Section 10(b)[480] and SEC Rule 10b-5[481] in the context of insider trading. The parity of information approach, which states that "anyone in possession of material inside information must either disclose it to the investing public, or...must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed," was described by the U.S. Court of Appeals for the Second Circuit. [482]

Section 16 of the Securities Exchange Act of 1934 places limitations on "short-swing" reporting and trading for officers, directors, and owners of 10% or more of the equity of publicly traded

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[478] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc); infra note 25 and accompanying text

[479] United States v. Chiarella, 588 F.2d 1358, 1365 (2d Cir. 1978), rev'd, 445 U.S. 222 (1980); infra note 26 and accompanying text.

[480] 15 U.S.C. § 78j(b) (2000).

[481] 17 C.F.R. § 240.1Ob-5 (2003). See generally Ralph C. Ferrara & Marc I. Steinberg, A ReappraisalofSanta Fe: Rule Ob- 5 and the New Federalism, 129 U. PA. L. REV. 263 (1980).

[482] Texas Gulf Sulphur Co., 401 F.2d at 848.

businesses.[483] In accordance with Section 16(b), if these people buy and sell (or sell and buy) an equity security of a relevant firm within a six-month period, they must disgorge any gains.[484] One of the many challenging issues it presents is whether Section 16 should be abolished after fulfilled its historical purposes.[485] With regard to the prior financial catastrophes, Section 16(a) has strong Congressional backing and will surely be vigorously enforced.[486] The first step toward regulating the disclosure of business stock transactions was the Securities Exchange Act of 1934. The SEC defines insiders as directors, executives, or anybody else with knowledge or who owns more than 10% of any class of a company's stocks.[487] Within 10 days of taking on an insider role, a person must file SEC Form 3, Initial Statement of Beneficial Ownership of Securities.[488] Within two business days of the transaction, insiders are required to file Form 4, Statement of Changes in Beneficial Ownership. This form acts as a public disclosure of insider trading activity.[489]

4.2.1.3.1 Mechanism to contain Tender Offer in Insider Trading

Only a tender offer qualifies for the application of SEC Rule 14e-3.[490] In contrast to Section 10(b), the prohibitions on trading on and disclosing significant inside information in this particular case are much more stringent. Until this information has been sufficiently revealed to the public (and absorbed), a person who acquires material nonpublic information about a tender offer directly or indirectly from the offeror (bidder), target firm, or an intermediary is barred from trading or tipping

[483] 15 U.S.C. § 78p (2000).
[484] Whittaker v. Whittaker Corp., 639 F.2d 516 (9th Cir. 1981); Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943).
[485] Marleen A. O'Conner, Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b), 58 FORDHAM L. REV. 309 (1989).
[486] Pursuant to Section 403 of the Sarbanes-Oxley Act of 2002, Section 16(a) was amended to require officers, directors, and 10 percent equity holders to report to the SEC their purchases and sales of subject securities more promptly, generally by the end of the second day after the transaction.
[487] U.S. Securities and Exchange Comission. "Investor Bulletin | Insider Transactions and Forms 3, 4, and 5
[488] U.S. Securities and Exchange Commission. "Form 3 | Initial Beneficial Ownership of Securities
[489] U.S. Securities and Exchange Commission. "Form 4 | Statement of Changes in Beneficial Ownership
[490] 17 C.F.R. § 240.14e-3 (2003). Rule 14e-3 was adopted in Securities Exchange Act Release No. 17120, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) 82,646 (Sept. 4, 1980).

under Rule 14e-3.[491] A tipper of material nonpublic information about a tender offer who knows or should know that the relevant information originates directly or indirectly from an offeror, target company, or intermediary is also not allowed to trade or tip before the information has been sufficiently disseminated (and absorbed) by the public.[492]

Rule 14e-3 establishes an exception to this broad disclose or abstain requirement for multi-service financial firms that adopt and implement adequate screening mechanisms that successfully prevent the communication of nonpublic information to those who execute or recommend transactions in the securities of the subject corporation.[493]

4.2.1.4 Role of Regulators and Courts in the light of Applicable theories of Insider Trading

Trading by corporate officials, directors, or other company employees having significant access to confidential information must be reported to the Securities and Exchange Commission (SEC) by the firm in question. According to federal law, a "insider" is a person who holds at least 10% of a company's equity securities or is one of the company's executives or directors. The use of such insiders' nonpublic information has been made illegal by Congress on the grounds that it illegally breaches the insider's fiduciary obligation to the corporation. Under the classical theory of insider trading, courts may impose liability for insider trading under Rule 10b-5.[494]

Insiders may be held responsible if they "tip" friends about important non-public information that could affect the value of the company's publicly traded stock. The issue of how to prosecute these people arose. In the modern world, a friend who receives such a tip has the same obligations as the insider who is ascribed to them. In other words, a buddy is not permitted to make a deal using

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[491] 17 C.F.R. § 240.14e-3(a), (d) (2003). The Supreme Court upheld Rule 14e-3's validity in United States v. O'Hagan, 521 U.S. 642 (1997)

[492] 17 C.F.R. § 240.14e-3(d) (2003).

[493] SEC Division of Market Regulation, "Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Nonpublic Information," [1989-1990 Transfer Binder]

[494] https://www.law.cornell.edu/wex/insider_trading last accessed on 14.08.2022

that confidential information. Insider trading occurs when the duty is broken, which gives rise to responsibility. To be found guilty, however, the individual receiving the tip must have known or ought to have known that the information was corporate property. In regards to this kind of insider trading, the U.S. Supreme Court's judgment in Dirks v. SEC was crucial. The constructive insider rule was also developed by Dirks, and it presumes people who work for a company professionally as insiders if they come into contact with sensitive information.[495] A person who trades on any stock based on the misappropriated knowledge is subject to criminal liability under 17 CFR 240 & 10b5-1, which was made possible by the advent of the misappropriation theory of insider trading in O'Hagan. The concepts of information equality and equitable access for Section 10(b) purposes are currently "dead"[496]."

The Section 10(b) insider trading restriction is instead interpreted by the U.S. Supreme Court based on fiduciary duty, trust, and confidence principles.[497] The information's "substantiality"[498] and "publicness,"[499] or whether it has been fully revealed to and incorporated by the investment community, are other crucial considerations in this context. "Anyone, whether a business insider or not, who frequently receives important nonpublic information has a duty to disclose or abstain,"[500] according to the equal access approach, which represents a more constrained view. When examining the possibility of tipper-tippee responsibility, lower courts pretended that a tipee assumed the position of her tipper.[501] Therefore, the "disclose or abstain" rule also applied to tipees

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[495] Dirks v. SEC, 463 U.S. 646 (1983) https://www.law.cornell.edu/wex/insider_trading
[496] Dirks v. SEC, 463 U.S. 646 (1983); Cbiarella, 445 U.S. at 222.
[497] Chiarella, 445 U.S. at 230 (opining that such liability "is premised upon a duty to disclose arising from a relationship of trust and confidence").
[498] Basic, Inc. v. Levinson, 485 U.S. 224, 232, 240, & n. 18 (1988); Ganino v. Citizens Utilities Company, 228 F.3d 154 (2d Cir. 2000); SEC v. Mayhew, 121 F.3d 44 (2d Cir. 1997).
[499] United States v. Libera, 989 F.2d 596, 601 (2d Cir. 1993); In re Faberge, Inc., 45 S.E.C. 244, 256 (1973).
[500] Chiarella, 445 U.S. at 231.
[501] Elind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974).

who intentionally got sensitive information from tippers who were unable to use it for their own benefit. [502]

Regarding "outsiders," [503] or individuals who do not bear a fiduciary duty to those who are on the other side of the subject transaction(s), the misappropriation theory may be applicable. [504] Regardless of whether the source of the information is (or is not) a party to the transaction, this view holds that Section 10(b) is violated whenever a relevant person uses significant secret information for securities trading.[505] As a result, there is a breach in the relationship of trust and confidence between the concerned party and the information source. As an illustration, when a worker misuses critical nonpublic information that his employer gave him and uses it to trade in the subject securities, he breaks the trust and confidence owed to his employer and maybe to his employer's clients.[506]

4.2.1.5 Materiality; An Obstacle to Enforce Insider Trading Regulations

The most recent corporate scandals involving Enron Corp., Global Crossing Ltd., Tyco International Ltd., SAC Advisor LP. and WorldCom Inc. (among others) have drawn the attention of regulators, the media, and the general public to insider trading and other types of corporate and individual securities fraud. [507] The federal securities laws, corporate governance, and a new, quick-moving, aggressive regulatory agenda are all being driven by this focus. [508] These changes are

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[502] Elkind, 635 F.2d at 156; Shapiro, 495 F.2d at 228.
[503] Temporary or Constructive Insiders
[504] United States v. O'Hagan, 521 U.S. 642 (1997).
[505] United States v. Falcone, [2001 Transfer Binder] Fed. Sec.L. Rep. (CCH) 1 91,489 (July 20, 2001).
[506] United States v. Newman, 664 F.2d 12 (2d Cit. 1981).
[507] These changes have been heralded and trumpeted by the press from the time that news of the full extent of Enron Corp.'s corporate fraud first became public. See, e.g., David Callahan, Private Sector, Public Doubts, N.Y. TIMES, Jan. 15, 2002, at A21; Stephen Labaton, S.E.C.'s Leader Evolves Slowly in a Climate Enron Altered, N.Y. TIMES, May 3, 2002, at C1; David Leonhardt, A Prime Example of Anything-Goes Executive Pay, N.Y. TIMES, June 4, 2002, at C1; Bruce Nussbaum, Can Trust Be Rebuilt?, BUS. WK., July 8, 2002, at 32; Lee Walczak et al., Let the Reforms Begin, BUS. WK., July 22, 2002, at 26.
[508] The agenda to date has included, among other things, the adoption by Congress of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) [hereinafter Sarbanes-Oxley], and a series of regulatory initiatives at the

primarily recommended for public company accounting methods. Now more than ever, federal securities laws and regulations need to be significantly revised to improve clarity, particularly to those controlling aspects of securities fraud. Antifraud measures may only be violated to a lesser extent through increased clarity, which would result in successful conviction and accountability of those held liable.[509] The idea of materiality is a crucial part of American insider trading regulation that has an effect on transaction design. Although the federal securities laws define materiality using the same, well-known legal criteria for many different purposes, the concept of materiality as it is used to U.S. insider trading regulation has produced distinct planning issues for public corporations and their insiders.[510] The fact that the United States' judicially established insider trading law functions as a transactional disclosure rule that, in contrast to other disclosure requirements under the federal securities laws, gives issuers and their insiders no specific disclosure content guidance is the cause of this unusual effect. As a result, even though corporate issuers and their directors and officers are aware that they cannot trade while in possession of materially untrue information, it is challenging for them to comprehend their obligations under the law due to the vague legal standard that currently governs what constitutes "material" information.

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U.S. Securities and Exchange Commission ("SEC"). See, e.g., 17 C.F.R. § 205.1-205.7 (2003); id. § 240.10A-2 (2003); id. §§ 228.303(c), 229.303(a)(4)-(5), 249.220f (Form 20-F Items 5E-5G), 249.240f (Form 40-F (11)-(13)) (2003). Interestingly, Professor Stephen Bainbridge predicted this phenomenon with uncanny accuracy, some might say, in 2000. See Stephen M. Bainbridge, Mandatory Disclosure: A Behavioral Analysis, 68 U. CIN. L. REV. 1023, 1058 n.169 (2000) ("[A] few well publicized securities fraud cases could result in the adoption of onerous securities regulation even if the vast majority of corporate managers are honest and trustworthy.").

[509] See Mike France & Dan Carney, Why Corporate Crooks Are Tough to Nail, BUS. WK., July 1, 2002, at 35 (noting that successful prosecution of corporate wrongdoers is difficult because, among other things, "[t]he laws regulating companies are ambiguous").

[510] See, e.g., Bainbridge, supra note 1, at 1028-34 (noting that a public issuer's determination of what constitutes material information is complicated by the notion that the value of corporate disclosure declines when the market is flooded with too much information); Bochner & Bukhari, supra note 10, at 228 (discussing ways in which materiality assessments as to financial results often are difficult).

[511] See supra note 12; infra Part II (describing the current legal standard defining materiality and its application in the insider trading context); see generally John M.Fedders, Qualitative Materiality: The Birth, Struggles, and Demise of

4.2.1.6 Critique of the U.S. Insider Trading Prohibition

The US's insider trading laws have come under limelight. The lawfulness of dealings that are conducted or evaluated nowadays is governed by fiduciary obligation, financial gain, and misappropriation principles as a result of Supreme Court decisions. Notwithstanding the Congress enacted the federal securities acts to provide better investor protections than state law, that congressional goal is minimized by the Supreme Court's extensive reliance on state law-based fiduciary obligation concepts. The objective of providing common investors with access to important nonpublic information on an equal basis with market experts no longer exists[512].

The fact that the SEC has increased restrictive Supreme Court law while purportedly acting within its regulatory authority may not come as a surprise. In the case of tender offers, for instance, the SEC's adoption of Rule 14e3 lays out strict anti-tipping rules as well as broad parity of information standards. In the framework of Section 10(b), the SEC has advanced a "flexible"[513] interpretation of Supreme Court precedent that includes releasing new rules that "practically overturn" precedent from lower courts. [514] The SEC also adopted Regulation FD, which tries to stop insiders of firms from selectively revealing important nonpublic information to institutional investors, market analysts, and other favored parties. Prior to the Supreme Court's Dirks decision, such selective disclosure was illegal in this country. However, it is still illegal in a number of other nations. It is

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an Unworkable Standard, 48 CATH. U. L. REV. 41 (1998) (describing the continually evolving SEC mandatory disclosure requirements and the difficulty of determining whether a fact not mandated to be disclosed by an SEC rule is otherwise material to the total mix of information).

[512] Chiarella, 445 U.S. at 245-52 (Blackmun, J., dissenting).

[513] Two such examples are the SEC's assertion that applicable Supreme Court decisions allow for broad interpretations of trading "on the basis of' inside information and the requisite "benefit" for tipping purposes. See, e.g., SEC v. Adler, 137 F.3d 1325 (11 th Cir. 1998) (rejecting SEC's assertion but adopting a presumption of use when one trades while knowingly possessing material nonpublic information); SEC v. Stevens, SEC Litigation Release No. 12813 (Mar. 19, 1991) (settlement where SEC alleged that insider received personal benefit under Dirks test by "tipping" inside information to securities analysts).

[514] Securities Exchange Act Release No. 43154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) 86,319 (Aug. 15, 2000). Generally, Regulation FD

only considered insider tipping under Section 10(b) jurisprudence if the tipper intends to personally profit from the selective disclosure.[515]

The inconsistent application of American insider trading laws is demonstrated by a few real-world examples. One striking example is the different treatment of tender offers as a result of SEC Rule 14e-3. Literally, whether a transaction qualifies as a tender offer or if gains were made by trading on material inside information could determine whether a person is held liable. For instance, Barry Switzer, a respected corporate executive who coached football for the Dallas Cowboys and the University of Oklahoma, unwittingly obtained sensitive information about an upcoming merger from him[516]. Switzer and his buddies used the information to their advantage to trade, making a tidy profit because they had a friendship with the executive and knew it to be accurate. The executive was not aware that Switzer had access to the pertinent messages, hence no illegal tipping occurred. Because a tippee's obligation under Section 10(b) is derivative, as was the case in Dirk v. SEC, the conclusion that the insider-tipper had not violated his fiduciary responsibilities meant that Switzer, as the tippee, had traded correctly and was thereafter permitted to keep his winnings[517]. Switzer would have escaped punishment under Section 10(b), but he would have broken Rule 14e-3 by using crucially sensitive information that he knew came from a reliable inside source in his trade. As a result, regardless of the liability of the tipper, a tippee is accountable under Rule 14e-3 for trading on information that is materially confidential and comes either directly or indirectly from a subject corporation. Switzer was able to dodge responsibility due to the way the subject deal was structured, allowing for the retention of substantial profits.

[515] Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980),
[516] SEC v. Switzer, 590 F. Supp. 756, 758, 762 (W.D. Okla. 1984).
[517] Dirks v. SEC, 463 U.S. 646, 660-64 (1983).

The Chestman,[518] which involved a criminal investigation, makes this inconsistency further clearer. Chestman was protected from Section 10(b) penalties according to the Second Circuit is en banc[519] judgment there because his informant had not broken a fiduciary duty by revealing crucial nonpublic information about an upcoming tender offer. Chestman's criminal conviction for breaking Rule 14e-3, however, was upheld because he willfully traded despite having critical inside information about a tender offer that originated, directly or indirectly, from the bidder or target corporation. Chestman was thereby held accountable under Rule 14e-3 notwithstanding the fact that the "deal"[520] was unfavorably constituted as a tender offer as opposed to another practical acquisition alternative, like a merger, exchange of shares, or sale of assets. Such differential treatment is incompatible with market integrity, investor protection, or the fundamental principles of treating similarly situated market actors equitably. [521]

The Chestman decision has still another drawback. The court determined that while determining whether a fiduciary responsibility existed and gave rise to the disclose or abstain mandate, marriage, taken alone, did not constitute a fiduciary tie. For such a relationship of trust and confidence to exist, other features must be present, such as an understanding to respect the confidentiality of the sensitive information or a preexisting status as a recipient of family business secrets.[522]

The court's reasoning effectively puts a stockholder's relationship with a director of a publicly traded company—someone he or she has never spoken to or met—above that of the stockholder's

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[518] United States v. Chestman, 947 F.2d 551 (2d Cir. 1991) (en banc).
[519] En banc means full court
[520] Chestman, 947 F.2d at 558.
[521] United States v. Naftalin, 441 U.S. 768, 775-76 (1979) (stating that purposes of Securities Act include "investor protection," achieving "a high standard of business ethics... in every facet of the securities industry," and observing that "the welfare of investors and financial intermediaries are inextricably linkedfrauds perpetrated upon either business or investors can redound to the detriment of the other and to the economy as a whole").
[522] SEC v. Lenfest, 949 F. Supp. 341 (E.D. Pa. 1996); United States v. Reed, 601 F. Supp. 685 (S.D.N.Y.), rev'don other grounds, 773 F.2d 477 (2d Cir. 1985).

spouse, child, parent, or sibling in addition to downplaying "family values." This result was made possible by the U.S. Supreme Court's emphasis on the existence of a fiduciary duty (or a relationship of trust and confidence) based on state law principles. Without a concept based on fair access, state law fiduciary duty rules may produce an absurd result, as they did in Chestman.[523] The SEC effectively invalidated this part of Chestman by passing Rule 10b5-2.[524] Unless the recipient can prove that there was no reasonable expectation of confidentiality given the nature of the familial relationship, the law applies the Section 10(b) misappropriation theory whenever someone obtains sensitive information from a spouse, child, parent, or sibling. [525] It is still unclear whether the SEC's rule adoption will continue. [526] After all, the U.S. Court of Appeals' decision has been "overturned" by the Commission. [527] The aforementioned evidence demonstrates that insider trading is prohibited by US law. Since insider trading is often not protected by statutes, this matter is typically handled by the courts. [528]

The U.S. Supreme Court rejected the arguments for parity of information and equal access, upholding the conventional state law concepts of fiduciary duties. The Chestman and Switzer verdicts serve as evidence that this method has resulted in absurd lower court precedent. In an

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[523] In a separate opinion, Judge Winter reasoned: [F]amily members who have benefitted from the family's control of the corporation are under a duty not to disclose confidential corporate information that comes to them in the ordinary course of family affairs. In the case of family-controlled corporations, family and business affairs are necessarily intertwined, and it is inevitable that from time to time normal familial interactions will lead to the revelation of confidential corporate matters to various family members. Indeed, the very nature of familial relationships may cause the disclosure of corporate matters to avoid misunderstandings among family members or suggestions that a family member is unworthy of trust

[524] 17 C.F.R. § 240.10b5-2 (2003).

[525] Selective Disclosure and Insider Trading, Securities Exchange Act Release No. 43154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) T 86,319 (Aug. 15, 2000).

[526] Cf. The Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (invalidating SEC Rule 19c-4).

[527] Selective Disclosure and Insider Trading, Securities Exchange Act Release No. 42259, [1999-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) 86,228, at 82,863-64 (Dec. 20, 1999) (release proposing Rule 10b5-2 and expressing dissatisfaction with Cbestman as being too restrictive).

[528] Statutory treatment exists with respect to certain issues relating to insider trading, such as "short-swing" trading, option traders, insider trades during specified "blackout" periods, the ability of contemporaneous traders to bring a private right of action, the levying of money penalties, and the adoption of specific mechanisms to be implemented by broker-dealers and investment advisers.

additional effort to counteract their restrictive views on the Section 10(b) regulation governing insider trading, the SEC has offered expansive interpretations of the Supreme Court decisions. The SEC became frustrated with its limited jurisdiction under Section 10(b) and responded by creating Rules 14e-3. The end consequence is far too frequently a mishmash of insider trading regulations that offer investors no protection. Therefore, it is not advisable to replicate the insider trading framework used in the United States.

4.2.1.7 Penalties of Insider Trading under US Laws

Insider trading regulation is mostly derived from court decisions because the SEC's proposed definitions of what insider trading is and who can be penalized for it leave little room for interpretation.

"Whenever it shall appear to the commission that any person has violated any provision of this title or the rules or regulations thereunder by purchasing or selling a security or security-based swap agreement... while in possession of material, nonpublic information... "[529]

This implies that anyone who pursues and follows up on nonpublic info could face an insider trading charge. Diversifying the states with established business cultures, however, are just beginning to adopt insider trading regulations or do not already have legislation in place Many countries have categorically stated that they do not pursue insider trading convictions, or if they do, they only enforce financial penalties. In 1961, the Securities and Exchange Commission (SEC) of the United States began prosecuting insider trading when a company employee informed his broker that the company would be reducing its dividend. The broker sold the stock for his wife and clients before the information was made public. He received a $3,000 fine and a 20-day

[529] Securities Exchange Act, 1934.

suspension from the New York Stock Exchange as his punishment. As reported: *"Many countries do not pursue insider-trading convictions, or if they do, only impose financial penalties."*[530]

In fact, "the SEC has filed lawsuits against corporate officers, executives, organization representatives, friends, business partners, relatives, government employees, and other individuals who exploited classified data." [531] Insider trading is punishable by up to 20 years in prison and a $5 million fine. The Sarbanes-Oxley Act of 2002 increased these fines. [532] Additionally, "those sentenced for insider trading may be subject to common punishment fines, which may be up to multiple times the benefit obtained or misfortune avoided as a result of an unlawful purchase." [533] The Sarbanes-Oxley Act, [534] the most significant update to the United States' securities regulations since the New Deal era, [535] is proof that more attention is being paid to corporate responsibility and ethical standards. [536] The continuous focus on insider trading legislation is related to this development. [537]

Insider trading has existed for as long as there have been stock markets, so it is nothing new. Other people outside just corporate directors could also be found guilty of insider trading. Stories about Martha Stewart's alleged insider trading violations in the US underscore this scrutiny.[538] For instance, the SEC charged Martha Stewart with securities fraud, including insider trading, and

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[530] https://www.economist.com/finance-and-economics/2011/10/15/tipping-the-scales
[531] Astarita, Mark J., "Introduction to Insider Trading: The Legal Versus the Illegal," SEC law.com, 2010. http://www.seclaw.com/docs/insidertrading033104.htm (last accessed 20 November 2021).
[532] Brody, Steven, "Criminal Insider Trading: Prosecution, Legislation, and Justification," The Selected Works of Steven Brody, 2009. http://works.bepress.com/cgi/viewcontent.cgi?article=1000&context=steven_brody (last accessed 20 November, 2021).
[533] Securities Exchange Act, 1934.
[534] Sarbanes-Oxley act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). See generallyharolds. Bloom- Enthal, Sarbanes-Oxley Act In Perspective (2002); James Hamilton & Ted Trautmann, Sarbanes-Oxley Act Of 2002: Law And Explanation (2002).
[535] See Securities Act of 1933, 15 U.S.C. § 77 (2000); Securities Exchange Act of 1934, 15 U.S.C. § 78 (2000).
[536] See John T. Bostelman et al., Enactment of BroadAccounting, Corporate GovernanceReform Act BringsNew Prohibitions,Requirementsfor Executives and Auditors, 34 Sec. Reg. & L. Rep. (BNA) 1281 (2002).
[537] See generallyWILLiAM K. S. WANG & MARC I. STEINBERG, INSIDER TRADING (1996 & Supp. 2002).
[538] See Editorial, Martha,Martha,Martha, WALL ST.J., Oct. 24, 2002, at A16; Alessandra Stanley & Con- stance L. Hays, MarthaStewart'sTo-Do List May Include Image Polishing,N.Y. TIMES, June 23, 2002, § 1, at I.

obstruction of justice in 2003 for her involvement in the 2001 ImClone case.[539] Based on data from Merrill Lynch broker Peter Bacanovic, Stewart sold about 4,000 shares of biotech business ImClone Systems. Samuel Waksal, the CEO of ImClone Systems, liquidated all of his stock before giving Bacanovic his advice. This occurred at the same time that ImClone was awaiting word from the Food and Drug Administration (FDA) regarding the approval of their cancer therapy, Erbitux. ImClone's medication was denied by the FDA shortly after these sales, which led to a 16% drop in share price in one day. Stewart's early sale prevented her from suffering a $45,673 loss. The Martha Stewart case generated much discussion on the ethics of insider trading. In 2004, she was charged with nine counts of securities fraud in violation of 15 U.S.C. Subsections 78j(b), 78ff, and 17 C.F.R. Section 240.10b-5. She was sentenced to five months in prison, an additional two years of managed discharge, as well as restitution and fines totaling more than $200,000. Her notoriety also suffered a great deal of misfortune. The fallout from this incident includes potential escape provisions in insider trading rules as well as the need for sufficient obstacles to make the violation less tempting. Many governments may believe that it is crucial to reevaluate their rules on insider trading in light of the Stewart case and other comparable incidents. Several countries are strengthening their existing legislation and allowing for greater application.[540]

The Galleon Group's former stock investments supervisor Raj Rajaratnam is one of the most recent and significant cases in the United States. He was sentenced to 11 years in prison after being accused on 14 counts of securities fraud. This was the longest prison sentence ever imposed for

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[539] *United States v. Stewart*, No. 03 CR 717(MGC), 2005. 433 F.3d 273 (2d Cir. 2006)

[540] Securities and Exchange Commission v. Martha Stewart and Peter Bacanovic, 03-CIV-4070 (NRB)(S.D.N.Y.) https://www.sec.gov/litigation/litreleases/lr18169.htm last accessed on 08.09.2023

insider trading, and Rajaratnam will pay the largest punishment in history: $92.8 million."[541] The United States took action in thirty-five cases in 2009 alone, resulting in criminal charges in thirty-one of them. Nine of these cases involved benefits or avoided losses of at least $4 million, and more than one-third of them needed three or more parties to the litigation.[542] The law governing insider trading in the United States is a synthesis of federal statute, SEC regulations, and judicial interpretation. As a result, it has consistently been in a state of transition and has been exposed to some degree of vulnerability.

4.2.2 Insider trading Laws/Regulations in China

4.2.2.1 Definition of Insider Trading

In China, "inside information" is commonly defined by Article 69(1) of the Securities Law as follows: Insider information is information that is not made public because it is relevant to the company's operations or finances during a securities transaction or because it could have a significant impact on the market value of the company's securities.[543] This wide criterion, meanwhile, might be overly ambiguous and ill-defined, which might make it exceedingly challenging to settle disputes and for insiders to evaluate if they must disclose knowledge before trading. Art. 69(2) lists a few particular categories of information that are considered to be inside information in order to provide advice and make its application easier:

1. the significant occurrences stated in Article 62's second paragraph;
2. a company's plans for dividend distribution or an increase in registered capital;
3. significant changes to the equity structure of the company;
4. significant changes to the security for the company's debts;

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[541] Securities and Exchange Commission v. Rajat K. Gupta and Raj Rajaratnam, Civil Action No. 11-CV-7566 (SDNY) (JSR) https://www.sec.gov/litigation/litreleases/2012/lr22582.htm last accessed on 08.09.2022

[542] Krey, Michael, "Insider Trading Cases Big In Scope, Not Number, In 2009: Report," Investors.com, 2010..

[543] Art 69(1), Securities Law, China

5. any single mortgage, sale, or write-off of a significant asset used in the company's operations that exceeds 30% of the asset in question; and

6. potential legal responsibility for sizable damages as a result of an act by a company's director(s), supervisor(s), manager(s), deputy manager(s), or other senior management person(s).[544] The "major events" enumerated in Art. 62 also fall under the purview of inside information, as the first item states. The regime of continuous information disclosure stipulates that a corporation must disclose a long list of "major events" by filing an ad hoc report to the CSRC and the stock exchange where it is listed.[545]

In other words, inside information encompasses both "corporate information" that is produced internally by the issuer of the subject asset and "market information" that is produced externally but nonetheless significantly influences the issuer's stock price. Furthermore, it would seem that the term "inside information" does not only refer to information that is particular to one or more companies or securities.[546] Any classified(non-public) information that is price-sensitive,

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[544] Securities Law, 1998 Art 69(2).

[545] The 'major events' under this article include:

1. a major change in the company's business guidelines or scope of business;
2. a decision made by the company concerning a major investment or major assent purchase;
3. conclusion by the company of an important contract which may have an important effect on the company's assets, liabilities, rights, interests or business results;
4. incurrence by the company of a major debt or default on an overdue major debt;
5. incurrence by the company of a major deficit or incurrence of a major loss exceeding ten percent of the company's net assets;
6. a major change in the external production or business conditions of the company;
7. a change in the chairman of the board of director, or not less than one-third of the directors or the manager of the company;
8. a considerable change in the holdings of shareholders who each hold not less than five percent of the company's shares;
9. a decision made by the company to reduce its registered capital, to merge, to divide, to dissolve, or to file for bankruptcy;
10. major litigation involving the company, or lawful cancellation by a court of a resolution adopted by the shareholders' general meeting or the board of directors;
11. other events specified in laws or administrative regulations. As suggested by Arts 62 and 69, inside information is any material, non-public information, no matter whether it is derived from within the company whose securities are traded.

[546] Bornstein, Ronald E., and N. Elaine Dugger. "International Regulation of Insider Trading." Colum. Bus. L. Rev. (1987): 375.

regardless of whether it is particularly or generally related to securities, would be regarded as inside information, according to a literal interpretation of Art. 69. This should be directly pertinent to the state of government policies, which always have a broad market impact, affecting all companies or securities in the market, or at the very least a certain sector of them. It would be considered inside information in China if one of these government policies, like a change in interest rates, has a significant impact on the price of the affected stocks. In China, where government laws change quickly and are frequently misused by people with insider access to the market, this treatment is crucial.

Last but not least, research and analysis that take the form of deductions, conclusions, or inferences made or inferred from publicly available material are specifically exempt.[547] True, market research and analysis are fundamental to ensuring an efficient market.[548] Market studies and evaluations, nonetheless, could legally be considered inside information prior to public disclosure because they may result in a significant price change in the relevant stocks, particularly if the analyst is powerful. This would forbid the use or dissemination of research findings, which is obviously at odds with the realities of business. Market research and analysis would be treated as public in order to address this issue if they are founded on information that is readily accessible to the general public and do not qualify as inside information.

4.2.2.2 Evolution of Regulatory Regime

The extremely potent Provisional Regulations on the Administration of Stock Issuance and Trading (Provisional Regulations) were published by the State Council in April 1993.[549] Despite having a

[547] Jinzhi Zhengquan Qizha Xingwei Zanxing Banfa [Provisional Measures for the Prohibition of Securities Fraud], 2 September 1993, PRC, Art 5.
[548] For a theoretical discussion of the role of the investment analyst, see D R Fischel, 'Insider Trading and Investment Analyst: An Economic Analysis of Dirks v Securities and Exchange Commission' (1984) 13 Hofstra L Rev 127.
[549] Gupiao Faxing yu Jiaoyi Guanli Zanxing Tiaoli [Provisional Regulations on the Administration of Stock Issuance and Trading], 22 April 1993, PRC (Provisional Regulations).

number of significant anti-insider trading provisions, this rule lacked specific definitions for insiders and inside information. The Provisional Measures for the Prohibition of Securities Fraud (Provisional Measures) were soon after published by the CSRC in September 1993.[550] Insider trading was one of several fraudulent practices in the stock market that this rule was created particularly to curb. Insider trading was covered by a set of very specific, comprehensive laws. Insider trading was added to the Criminal Law of the People's Republic of China (Criminal Law) by the National People's Congress (NPC) in October 1997.[551] It should be noted that the Criminal Law refers to other laws and regulations regarding insider trading rather than defining insider trading. A national securities law was created as a result of the belief that current government regulations were not sufficiently addressing regulatory requirements. It was also thought that this legislative process had been influenced by the well-known 1997 Asian financial crisis.[552] The long-awaited People's Republic of China Securities Law (Securities Law) went into effect in July 1998.[553] This was a significant turning point in Chinese securities regulation. Insider trading received some attention from the Securities Law, which included up to five articles on the topic.[554] Even while this insider trading system was not without issues, it prepared the path for China to regulate insider trading according to the rule of law.

As was said above, despite China's relatively recent history of securities legislation, the country

[550] Jinzhi Zhengquan Qizha Xingwei Zanxing Banfa [Provisional Measures for the Prohibition of Securities Fraud], 2 September 1993, PRC (Provisional Measures).
[551] Zhonghua Renming Gongheguo Xingfa [Criminal Law of the People's Republic of China], October 1997, PRC (Criminal Law).
[552] R Tomasic and J Fu, 'The Securities Law of the People's Republic of China: An Overview' (1999) 10 Aust Jnl of Corp Law 268 at 269. However, some commentators thought that the outbreak of the 1997 Asian financial crisis frightened the Chinese government which became more cautious about the stock market and thus retarded the process of the lawmaking. See Wu Hong et al, Zhongguo Zhengquan Shichang Fazhan de Falu Tiaokong [Legal Control on the Development of China's Securities Market], above n 1, p 18.
[553] Zhonghua Renming Gongheguo Zhengquanfa [Securities Law of the People's Republic of China], 1 July 1999, PRC (Securities Law).
[554] These Articles will be critically examined in detail in the following parts.

has made an impressive feat in establishing its insider trading regime. It is vital to note a few key aspects of China's insider trading legislation. The government has demonstrated a strong desire to control insider trading, which is the first factor. With no opposition to the premise that insider trading should be forbidden, the regulation of insider trading in China was born in the very early stages of the stock market. China stands out in this regard from other countries where the issue of whether to criminalize insider trading has been hotly contested. For instance, Japan did not have insider trading restrictions until its stock exchange law was modified in 1988.[555]

Although the UK stock market has existed since the last quarter of the seventeenth century, insider trading was not made a crime there until 1980.[556] The use of international expertise is the other characteristic of China's insider trading law.[557]

China's securities legislation had a strong foundation thanks to the sophisticated overseas expertise. This may provide an explanation for why China set up its insider trading regime so efficiently. Since insider trading was first outlawed in China in 1990, thanks to the advantages of international experience, its regulations have solidified and grown more practical. But there are still certain issues as a result of drawing from foreign expertise. China seems to have imported Western expertise with too much haste. In fact, the Chinese government has come to believe that comparable laws and regulations to those in existence in industrialized nations are necessary for China to be able to build its securities market successfully. This has had a negative impact on the legislative process, making it unable to ponder carefully enough on the necessity, scope, and ramifications of Chinese law. China's insider trading regulation is therefore not very effective in

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[555] See, eg, T Akashi, Note, 'Regulation of Insider Trading in Japan' (1989) 89 Colum L Rev 1296 at 1298–9 (stating that the Japanese authorities lacked enthusiasm to regulate insider trading); F A Gevurtz, 'The Globalization of Insider trading Prohibitions' (2002) 15. Transnational Lawyer 63 at 85 (maintaining that the Japanese government 'was not sure how much it really wanted to enact an insider trading prohibition').

[556] G Brazier, Insider Trading: Law and Regulation, Cavendish Publishing Ltd, 1996, pp 90–5.

[557] M Gu and R C Art, 'Securitization of State Ownership: Chinese Securities Law' (1996) 18 Mich J Int'l L 115 at 117.

reality.[558] There have only been a very few reported insider trading cases in China so far.[559]

4.2.2.3 Mechanism to curb Insider Trading/Role of Regulators & Courts to contain Insider Trading

The Securities Law of the People's Republic of China (the Securities Law), which was enacted in 1998, presently contains the important sections in Chinese insider trading legislation that provide technical effect to the regulatory goals.[560] It should be mentioned that on December 28, 2019, the Securities Law was changed with an effective date of March 1, 2020. The Securities Law gave insider trading a fair amount of attention, devoting up to five pages to topics including the definition of an insider, the range of insider information, and the categories of forbidden conduct. The regulatory framework for insider trading has been further elaborated and clarified. A staff manual on how to administer the insider trading statute was published by the CSRC in 2007 and was titled "2007 CSRC Guide on Insider Trading."[561] A unified judicial interpretation on the

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[558] See, eg, Chunfeng Wang et al, 'Insider Trading and the Regulation on China's Stock Market: International Experience and China's Response' (2003) 3 Guoji Jingrong Yanjiu [International Finance Research] 57 at 63 (stating that China's insider trading regulation needs to be improved); Donghui Shi and Hao Fu, 'The Regulation of Insider Trading in China: A Legal and Economic Study', paper presented at the Symposium on 'Behavioral Finance and Capital Market', Nanjing, China, 29–30 November 2003, p 36 (positing that 'China's insider trading regulation is not effective').

[559] Shunyan Zhen, Zhengquan Neimu Jiaoyi Guizhi de Bentuhua Yanjiu [Localized Study on Securities Insider Trading Regulation], 1st ed, Peking University Press, 2002, pp 58–65.

[560] Zhonghua Renmin Gongheguo Zhengquanfa [Securities Law of the PRC] (promulgated by the Nat'l People's Cong., Dec. 29, 1998, effective July 1, 1999) (amended 2014), CLI.1.233280(EN) (Lawinfochina). However, as this Article examines the relevant cases before June 2017 and the 2014 version of the Securities Law is the then-governing law, the term "Securities Law" is used to refer to the 2014 version unless otherwise indicated. 9. These articles will be examined in detail infra Part II.

[561] Zhongguo Zhengquan Jiandu Guanli Weiyuanhui (中国证券监督管理委员会) [China Sec. Regulatory Comm'n], Zhongguo Zhengquan Jiandu GuanliWeiyuanhui Guanyu "Zhenquan Shichang Caozong Xingwei Rending Zhiyin (Shixing)" ji "Zhengquan Shichang Neimu Jiaoyi Xingwei Rending Zhiyin (Shixing)" de Tongzhi [Notice of the CSRC Regarding the Printing and Distribution of the "(Provisional) Guide for the Recognition and Confirmation of Manipulative Behavior in the Securities Markets" and the "(Provisional) Guide for the Recognition and Confirmation of Insider Trading Behavior in the Securities Markets"] (2007) [hereinafter 2007 CSRC Guide on Insider Trading]. It should be noted that the 2007 CSRC Guide on Insider Trading is an internal guidance document, intended to help CSRC staff better understand the insider trading law and ensuring consistency of enforcement standards. Some scholars have raised concerns over its status from the perspective of administrative law. See, e.g., Nicholas Calcina Howson, Enforcement Without Foundation? Insider Trading and China's Administrative Law Crisis, 60 Am. J. Comp. L. 955 (2012) (arguing that the 2007 CSRC Guide on Insider Trading is void and unenforceable). Strictly speaking, the 2007 CSRC Guide on Insider Trading is not law and thus has never been cited as a legal basis in the CSRC administrative penalty decisions against insider trading. However, this supposedly internal document has now been made publicly available online, informing the market about the CSRC's view, policy, and interpretation of the insider

treatment of criminal insider trading cases was released by the Supreme People's Court (SPC) and the Supreme People's Procuratorate on March 29, 2012. [562]

Persons with knowledge of inside information on the trading of stocks are typically prohibited from utilizing that inside information to trade securities, according to Article 67 of the stocks Law of 1998. [563] Other articles, however, place limits on this wide net. According to Article 68, there are a number of particular categories of people who are deemed to be "persons with inside information" [564] the officers and directors of the company, [565] including the directors, supervisors, managers, deputy managers, and other top management figures. [566] Lower-level employees are also considered insiders if they have acquired inside information related to their employment, in addition to high management. [567] The most insiders might fall into this category. For the purposes of insider trading laws, significant stockholders are also insiders. [568] A shareholder in China is

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trading law, particularly ambiguous or open-ended provisions. In sum, the 2007 CSRC Guide on Insider Trading has played a very important role as widely accepted de facto insider trading law in China.

[562] Zuigao Renmin Fayuan and Zuigao Renmin Jianchayuan Guanyu Banli Neimu Jiaoyi and Xielu Neimu Xinxi Xingshi Anjian Juti Yingyong Falv Ruogan Wenti de Jieshi [Judicial Interpretation on Several Issues Concerning the Application of Insider Trading Law in Criminal Cases] (promulgated by Sup. People's Ct. & Sup. People's Procuratorate, Mar. 29, 2012, effective June 1, 2012), CLI.3.174356(EN) (Lawinfochina) [hereinafter 2012 Judicial Interpretation on Insider Trading Law in Criminal Cases]. In China's legal system, a judicial interpretation is a formal source of law and can only be issued by the Supreme People's Court and the Supreme People's Procuratorate.

[563] The Securities Law of The People's Republic of China, 1998, Article 67.

[564] They include:

1. Directors, supervisors, managers, deputy managers and other senior management persons concerned of companies that issue shares or corporate bonds;
2. Shareholders who hold not less than 5 percent of the shares in a company;
3. The senior management persons of the holding company of a company that issues shares;
4. Persons who are able to obtain material company information concerning the trading of its securities by virtue of the positions they hold in the company;
5. Staff members of the securities regulatory authority, and other persons who administer securities trading pursuant to their statutory duties;
6. The relevant staff members of public intermediary organizations who participate in securities trading pursuant to their statutory duties and the relevant staff members of securities registration and clearing institutions and securities trading service organizations; and
7. Other persons specified by the securities regulatory authority under the State Council. According to this list, statutory insiders can be categorized into several groups.

[565] The Securities Law of The People's Republic of China, 1998, Article 68(1).

[566] The Securities Law of The People's Republic of China, 1998, Article 68(3).

[567] The Securities Law of The People's Republic of China, 1998, Article 68(4).

[568] The Securities Law of The People's Republic of China, 1998, Article 68(2).

deemed to be a large shareholder and is therefore subject to regulations like the shareholding reporting requirement[569] and the ban on short-swing trading if they own 5% or more of the shares issued by a listed firm.[570]

The restriction against insider trading is not only applicable to the three kinds of traditional business insiders mentioned above. The temporary or constructive insiders are two more categories of people who are nominal outsiders but are still subject to the prohibition. These people include a variety of nominal outsiders who engage in securities trading as part of their official duties or private contracts, including underwriters, accountants, attorneys, consultants, and employees of securities registration and clearing institutions[571] the individuals who have regulatory authority over the trading of securities, or the regulatory officials. [572] In addition to the aforementioned principal insider trading scenarios, Chinese law also applies in situations where the misappropriation hypothesis serves as the sole justification for a breach. [573] A person who has unlawfully gained material nonpublic information is subject to an insider's duty under Art. 70 and is thus not permitted to trade based on the information. [574] To ensure greater efficacy of the ban, it is also laid forth under what conditions an insider may break the legislation governing insider trading. Persons in possession of inside information are forbidden from engaging in certain actions under Article 70, including trade, procurement, and tipping. [575] The insider trading legislation effectively prevents simple circumventions through the tipping and procurement restrictions. According to Art. 70, trading is not necessary in these two situations for liability to attach. [576] In

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[569] The Securities Law of The People's Republic of China, 1998, Articles 41 and 79.
[570] The Securities Law of The People's Republic of China, 1998, Article 42.
[571] The Securities Law of The People's Republic of China, 1998, Article 68(6).
[572]The Securities Law of The People's Republic of China, 1998 Article 68(5)
[573] For discussion of the misappropriation theory, see Pt IV (A)(2).
[574] The Securities Law of The People's Republic of China, 1998, Article 70.
[575] The Securities Law of The People's Republic of China, 1998, Article 70.
[576] The Securities Law of The People's Republic of China, 1998, Article 70.

other words, even if there was no transaction, the insider would still be responsible for tipping off the information or arranging the deal. Therefore, whether or not the tippee or the person convinced to trade actually trades has no bearing on the insider's liability.

In contrast, under US law, a tipper is not subject to 10b-5 liability if no trading takes place, because any violation of 10b-5 must be 'in connection with the purchase or sale of securities'.[577] This is based on the theories that there is no harm done to the market if there is no trading and that sharing important non-public knowledge improves market efficiency. However, China's legislators may have had a tendency to think that the insignificance of trading in the settings of tipping and procuring should preventively deter tipping and procuring behaviors that may eventually result in actual trading.

China's insider trading laws generally focus on the most common types of insider trading and make individuals who trade using stolen knowledge liable. Trading is not permitted, nor are tipping or procuring.[578] Article 73 of the Securities Law generally prohibits persons with knowledge of inside information on securities trading and persons who illegally obtain inside information from using such information to trade securities.[579] However, other publications narrow this broad net. Certain categories of people are specifically mentioned in Article 74 as "persons with knowledge of inside information."

This list allows for the division of statutory insiders into various groups. The first group consists of a corporation's [580] and its subsidiaries [581] directors and officers, which may include top management representatives such as directors, supervisors, managers, and deputy managers.

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[577] 15 USC § 78j(b) (2001). For a discussion of this issue, see, eg, W K S Wang and M I Steinberg, Insider Trading, 1st ed, Little Brown & Co, 1996, §4.4.5.
[578] Securities Law art. 76.
[579] Id. art. 73.
[580] Id. art. 74(1).
[581] Id. art. 74(3).

In addition to senior management, lower level staff workers are also considered insiders if they acquired inside information through their employment.[582] The most insiders might fall into this category. Third, for the purposes of the insider trading statute, significant (more than 5%) shareholders are also insiders.[583] The three groups mentioned above are all conventional business insiders, but they are not the only ones affected by the ban on insider trading. Two other groups of people fall under the prohibition even though they are ostensibly outsiders. One group includes a variety of nominal outsiders who engage in securities trading in accordance with their legal obligations or private contracts, such as underwriters, accountants, lawyers, consultants, and employees of securities registration and clearing institutions. This category is referred to as temporary or constructive insiders in the United States.[584]

The second category consists of regulatory personnel, specifically those with control over securities trading.[585] Enumerating insiders has the advantage of offering precise guidance, but it also runs the risk of being restrictive and unintentionally enabling loopholes. Due to its catch-all approach and reference to "other persons" listed by the CSRC, article 74's final subsection may close these gaps. The 2007 CSRC Guide on Insider Trading's Article 6(2) lists several examples of the types of individuals who may be covered by the aforementioned catchall provision, including (i) the issuer or listed company; (ii) other businesses controlled by the issuer or listed company's controlling shareholder or actual controller, including those businesses' directors, supervisors, and senior management; and (iii) parties and their relevant personnel involved in the listed company's mergers and acquisitions.[586]

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[582] Id. art. 74(4).
[583] Id. art. 74(2). In China, a shareholder with five percent or more of the shares issued by a listed company is considered a substantial shareholder.
[584] Id. art. 74(6).
[585] Id. art. 74(5).
[586] 2007 CSRC Guide on Insider Trading, supra note 10, art. 6(2).

To broaden the scope of its insider trading regulation, China has added the misappropriation theory from the United States in addition to the aforementioned basic insider trading examples. [587] A person who has unlawfully received material nonpublic information is subject to an insider's duty under article 76 and is thus not permitted to trade based on the information. [588] The 2007 CSRC Guide on Insider Trading expands on this provision to cover the following individuals: first, parents, children, and other family members who learn inside information because they are related to the insiders listed in Article 74 of the Securities Law; [589] second, individuals who learn inside information through unethical means, such as theft, cheating, tapping, spying, extraction, bribery, and private trading; [590] and third, individuals who learn inside information through other means.[591] The 2012 Judicial Interpretation on Insider Trading Law in Criminal Cases offers guidelines on how insider trading law should be applied in criminal processes, in contrast to the 2007 CSRC Guide on Insider Trading, which is intended for the CSRC to use in administrative procedures. A person may be judged to have obtained inside information unlawfully under article 2 of this agreement, which interprets section 76 of the Securities Law, if the inside information was acquired in one of the following three situations: (i) through illegal means like stealing, cheating, tapping, spying, extracting, bribery, and private trading; (ii) from primary insiders' close relatives or others with similar close relationships; and (iii) from those who come into contact with primary insiders during the crucial time when the inside information was obtained.[592] As a result, Article

[587] For discussion of the misappropriation theory, see, e.g., Michael P. Kenny & Theresa D. Thebaut, Misguided Statutory Construction to Cover the Corporate Universe: The Misappropriation Theory of Section 10(b), 59 Alb. L. Rev. 139 (1995); John R. Beeson, Rounding the Peg to Fit the Hole: A Proposed Regulatory Reform of the Misappropriation Theory, 144 U. Pa. L. Rev. 1077 (1996); Donna M. Nagy, Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion, 59 Ohio St. L.J. 1223 (1998).
[588] Securities Law art. 76.
[589] 2007 CSRC Guide on Insider Trading, supra note 10, art. 6(3).
[590] Id. art. 6(4).
[591] Id. art. 6(5).
[592] 2012 Judicial Interpretation on Insider Trading Law in Criminal Cases, supra note 11, art. 2.

76 casts a fairly wide net and offers a legal foundation for pursuing tippee liability as well as administrative or criminal insider trading liability against more people.

4.2.2.4 Penalties of Insider Trading in China

Anyone who knows insider information about the trading of securities or who illegally obtains such information and uses it to buy or sell securities, divulges it to others, or advises them to buy or sell securities will be required to dispose of the illegally obtained securities in accordance with the law. His illicit gains must be forfeited, and he must also pay a fine that is no greater than five times those gains, or no greater than the market value of the securities that were bought or sold illegally. Criminal culpability must be sought in accordance with the law if the offense qualifies as a crime. A securities regulatory authority employee faces harsher sanctions if he engages in insider trading. In the legal framework of Chinese corporate law, insiders include executives, chiefs, board members, shareholders, representatives, staff members of the CSRC, and other individuals who have been charged by the State Council's securities administrative specialist. These insiders are forbidden from trading using insider information, as well as acquisition and tipping.

A criminal charge, a maximum fine of multiple times the illegal proceeds from wrongfully obtained or sold shares, and, in the worst circumstances, a minimum ten-year prison sentence are the most severe sanctions for an insider trader. In an effort to make the insider trading regulations more likely to be upheld, China has started to demonstrate its authorization structure in response to the effective U.S. framework.[593] There had only been twelve openly reported insider trading incidents in China's brief market history. Between 2001 and 2005, the United States brought 271 required activities whereas China only brought three. The State Development Research Council's president, Wu Jinglian, described China's stock exchanges as "more terrible than a casino club"

[593] Shen, H. (2009). A comparative study of insider trading regulation enforcement in the US and China. J. Bus. & Sec. L., 9, 41

and a haven for conspiracy theorists.[594]

4.2.2.5 Enforcement of Chinese Insider Trading Law: An Empirical/Comparative Perspective

Here light will be shed on insider trading laws enforcement by Chinese regulators and criminal courts from the inception of Chinese securities markets in the early 1990s to the recent past, say 2020.[595] Enforcement strategies of securities law have traditionally been divided into two broad categories, namely public enforcement and private enforcement. In general, public enforcement is initiated by a state official, such as a regulator or a prosecutor, while private enforcement is carried out by a private party in the form of civil actions for compensation or rescission. Hence, the consequences of public enforcement may include penalties imposed by the regulator, which is called administrative liability in China, as the regulator (the CSRC) is an administrative body, as well as criminal liability imposed by a criminal court. On the other hand, private enforcement leads to what is known as civil liability in China, as the case is brought by eligible investors before a civil court.[596] Below is a brief discussion of the three types of legal liabilities for insider trading in China, namely administrative liability, criminal liability, and civil liability.

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[594] Ibid.

[595] Hui Hong, Robin, The American Journal of Comparative Law, Volume 68, Issue 3, September 2020, Pages 517–575, https://doi.org/10.1093/ajcl/avaa018 last accessed October 2022

[596] In many jurisdictions, the term "civil liability" may also refer to the liability the regulator can impose through a civil court, as opposed to civil cases brought by private investors (sometimes called private civil liability). Further, in some jurisdictions, such as Australia and Hong Kong, apart from civil liability, there is a special regime known as "civil penalty," which the regulator can seek through a civil court or a specialized tribunal. See Corporations Act 2001 (Cth) s 1317E (Austl.); Securities and Futures Ordinance (2002) Cap. 571, pt. XIII (H.K.) ("Market Misconduct Tribunal"). In China, the term "civil liability" is limited to civil cases brought by private investors, and the term "administrative liability" may cover the following three types of sanctions that the regulator can use in some overseas jurisdictions: (i) disciplinary sanctions that the regulator can impose mainly on licensed persons at its discretion; (ii) the civil liability that the regulator needs to go to a civil court to impose in overseas jurisdictions; and (iii) the civil penalty that is available in some jurisdictions. To facilitate the CSRC's enforcement, the CSRC has the power to impose administrative liabilities without having to apply to a court.

4.2.2.5.1 Administrative Liability

Article 202 of the Securities Law states that insider trading may result in many administrative penalties, such as the sale of unlawfully acquired stocks, the seizure of illicit earnings, and a fine.[597] There has been substantial discussion over how this clause should be applied, especially in respect to the crucial idea of "illegal proceeds." The meaning of the phrase "illegal proceeds" is not entirely evident from the phrasing of article 202. First off, does "illegal proceeds" include a loss that the insider would have endured absent the insider trading? According to some critics, "illegal proceeds" refers to "illegal profits," thus article 202 should be changed to include loss avoidance scenarios.[598] Additionally, article 202 makes no mention of how to determine illicit proceeds. Some advice on the aforementioned topics is provided in the 2007 CSRC Guide on Insider Trading. According to this, the term "illegal proceeds" refers to benefits received illegally as a result of insider trading, including profits made and losses saved as a result of insider trading.[599] The insider may receive illicit benefits in the form of cash or securities that they own or have influence over. This reading makes sense given that Article 202 prefers to refer to "illegal proceeds" (weifa suode) rather than "illegal profits" (weifa lirun). As a result, it appears intuitively obvious that article 202 can be applied to loss avoidance situations. To test this theoretical viewpoint, this article will use actual data. In order to determine the amount of illicit proceeds, it is required to first choose a

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[597] Zhonghua Renmin Gongheguo Zhengquanfa [Securities Law of the PRC] (promulgated by the Nat'l People's Cong., Dec. 29, 1998, effective July 1, 1999) (amended 2014), art. 202, CLI.1.233280(EN) (Lawinfochina) ("Where an insider who has access to inside information of securities trading or any person who has obtained any inside information purchases or sells the securities, divulges relevant information, or advises any other person to purchase or sell securities before the information regarding the issuance or trading of securities or any other information that may have any big impact on the price of the securities is publicized, he shall be ordered to dispose of the securities he illegally holds according to law. The illegal proceeds shall be confiscated and a fine of one up to five times the illegal proceeds shall be imposed. Where there is no illegal proceeds or the illegal proceeds is less than 30,000 yuan, a fine of 30,000 yuan up to 600,000 yuan shall be imposed. Where an entity is involved in any insider trading, the person in charge and any other person as held to be directly responsible shall be given a warning and be imposed a fine of 30,000 yuan up to 300,000 yuan . . . .").

[598] See, e.g., Charlie Xiaochuan Weng & Jingwei Jia, Assessing the Administrative Sanctions Regime for Insider Trading in China: An Empirical Approach, 10 Asian J. Comp. L. 343, 347 (2016).

[599] 2007 CSRC Guide on Insider Trading, supra note 10, art. 21.

"benchmark date" (jizhun riqi), at which point the share price can be used to determine the proceeds. The benchmark date may differ from case to case and may be the day on which insider trading operations cease, the day on which inside information is made public, the day on which the administrative investigation into the matter is concluded, or some other suitable date.[600]

In addition, two formulas are given for figuring out the unlawful proceeds, depending on whether the illegal proceeds come from saved losses or illegal profits. The amount of illegal earnings can be determined using the formula below if the insider buys with the help of favorable inside information before selling with illegal gains: The value of the securities still held by the insider at the benchmark date plus the cumulative proceeds from the sale of those securities plus the cumulative dividends received by the insider minus the cumulative proceeds from the purchase of those securities minus the proceeds from a rights offering minus transaction costs equals illegal profits.[601] Similar to this, the amount of loss saved in circumstances of loss avoidance can be determined using the following formula: the total amount of money made from selling securities, less the value of the securities on the benchmark date if they had not been sold, less transaction fees.[602] Despite how complex the formulas appear, there are significant uncertainties. The amount of illicit proceeds will vary depending on whether the insider sold the stocks at the time of the CSRC investigation and how the benchmark date is established in a typical situation where the insider trades on the basis of positive inside information. In the event that the insider has sold all pertinent securities, the illicit profit is primarily determined by deducting the price paid for the

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[600] Id. art. 22.

[601] Id. art. 23. The transaction costs include taxes paid to the government, commission fees paid to the securities firms, registration fees, and other reasonable fees incurred in the course of the transaction.

[602] . Id. 418

stocks from the price realized upon sale of the shares. This is the insider's actual profit, and in the US, the computation method is sometimes referred to as the net profit methodology.[603]

However, if the insider still owns the relevant stocks, the illicit profit is determined by deducting the cost of the securities' purchase from their value on the benchmark date. The benchmark date is decided on a case-by-case basis, as was said above. The actual profit as described above is the illegal profit if the benchmark date is determined to be the date of the CSRC investigation. The illegal profit, however, is the so-called notional profit—a profit that the insider would have been able to make from insider trading—and the calculation method is known in the United States as the market absorption approach if the benchmark date is the date the positive inside information was made public and the market absorbed the effects of the information (this date is typically before the date of the CSRC investigation).[604]

Since the profit has already been realized or the share price on the benchmark date is known, it is generally simpler to calculate the actual profit using the net profit approach. However, to calculate the notional profit using the market absorption approach, one must first determine the benchmark date at which the insider information is absorbed into the market. However, it can be difficult to use the real profit as illicit proceeds, especially when the insider is unable to generate a profit while having access to inside information. For instance, the insider might decide to hold onto the securities after they experience a price increase as a result of the disclosure of inside information, hoping that the price will increase further. However, if the market experiences a general downturn, which drives down the price of the securities, the insider may decide to sell the securities at a loss.

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[603] . Danielle DeMasi Chattin, The More You Gain, the More You Lose: Sentencing Insider Trading Under the U.S. Sentencing Guidelines, 79 Fordham L. Rev. 154 (2011).

[604] Id. 420

4.2.2.5.2 Criminal Liability

Article 180 of the Criminal Law has a detailed description of the criminal penalties for insider trading: When a person who has access to insider information about the trading of securities or futures, or anyone who has obtained any inside information, buys or sells securities or futures, discloses pertinent information, or explicitly or implicitly advises another person to buy or sell securities or futures before learning information about the issuance of securities, the trading of futures, or any other information that could have a significant impact on the price Additionally or solely, they will be fined an amount that is at least 100% but not more than 500% of their illegal proceeds. If the situation is particularly terrible, they will receive a term of between five and ten years in prison. They must also pay a fine that is at least 100% but not more than 500% of the amount of their illicit proceeds.[605] Therefore, the severity of the insider trading actions determines the criminal sentence. An additional explanation of "serious circumstances" and "very serious circumstances" as they relate to article 180 of the Criminal Law is provided in the 2012 Judicial Interpretation on Insider Trading Law in Criminal Cases. Among the events that would be deemed "serious" are (i) the cumulative trading amount of securities is greater than CNY 500,000; (ii) the cumulative amount of margin used for futures trading is greater than CNY 300,000; (iii) the cumulative profits or losses avoided are greater than CNY 150,000; (iv) insider trading is carried out; (v) inside information is leaked more than three times; or (v) any other significant event.[606] Additionally, "very serious circumstances" include (i) the cumulative trading amount of securities exceeds CNY 2,500,000 (ii) the cumulative amount of margin used for futures trading exceeds CNY 1,500,000 (iii) the cumulative amount of profits or losses avoided exceeds CNY 750,000 (iv)

[605] Zhonghua Renmin Gongheguo Xingfa [Criminal Law of the People's Republic of China] (promulgated by Nat'l People's Cong., Mar. 14, 1997, effective Mar. 14, 1997) (amended 2015), art. 180, CLI.1.256286(EN) (Lawinfochina).

[606] . 2012 Judicial Interpretation on Insider Trading Law in Criminal Cases, supra note 11, art. 6.

and (v) any other very serious circumstance.[607] The quantity of cumulative trading, the number of tippers or counselees with whom the insider has interacted, and the total number of transactions appear to be the major determinants of the seriousness of the situation. Thus, it will be empirically analyzed whether those elements are statistically significant in practice when calculating criminal punishments and whether there are any more significant elements.

4.2.2.5.3 Civil Liability

Except for a straightforward clause that generally gives private civil liabilities for all securities offenses priority, the Securities Law makes no mention of private civil liability for insider trading. According to Article 232 of the Securities Law,: "If the property of a person, who violates the provisions of this Law and who therefore bears civil liability for damages and is required to pay a fine, is insufficient to pay both the damages and the fine, such person shall first bear the civil liability for damages."[608]

Nevertheless, the Securities Law does not dedicate any explicit provisions to civil damages paid to the injured party by an insider trader. Article 232 is figurative because no provisions in the Securities Law specifically address the problems with civil remedies, such as the plaintiff's standing or the amount of damages, making private civil liability nearly impossible in practice.[609] A private right of action might theoretically be based on the tort system or the current general contract law. However, because to the unique characteristics of insider trading, such as the impersonality and anonymity of exchange transactions, it is highly challenging, if not impossible, to establish insiders' responsibility on those traditional bases for causation and reliance. The

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[607] Id. art. 7.

[608] Zhonghua Renmin Gongheguo Zhengquanfa [Securities Law of the PRC] (promulgated by the Nat'l People's Cong., Dec. 29, 1998, effective July 1, 1999) (amended 2014), art. 232, CLI.1.233280(EN) (Lawinfochina).

[609] For an in-depth analysis of the issues concerning private civil liability for insider trading, see Hui Huang, Compensation for Insider Trading: Who Should Be Eligible Claimants?, 20 Austl. J. Corp. L. 84 (2006).

Supreme People's Court of China published a circular on January 9, 2003, outlining specific guidelines for the hearing of civil securities proceedings, but the circular only applies to cases involving securities misrepresentation and not, for example, instances involving insider trading. However, Xi Xiaoming, the SPC's vice president at the time, said on May 30, 2007, that courts should also accept securities civil lawsuits resulting from insider trading and market manipulation. Later, the SPC transmitted Xi's declaration to courts nationwide at all levels as its official document.[610] Several civil lawsuits involving insider trading were then brought, but up until very recently, they were either abandoned or failed.[611] Overall, civil responsibility has not yet been very important in enforcing the Chinese insider trading law compared to administrative liability and criminal liability.

In recent years, China has considerably increased its efforts to combat insider trading. Although the Chinese insider trading law is primarily a transplant from other countries, its application has shown unique characteristics in the region. The degree of insider trading enforcement in China appears to be at a level equivalent to the relevant jurisdictions outside based on the nature, scope, and frequency of the punishments levied. Comparing the enforcement pattern and intensity level in China with six other jurisdictions, we examine how the insider trading law in China has been used in reality by the regulator and criminal courts. It is intended to accomplish three main goals, which are to measure the intensity of insider trading enforcement, generate descriptive statistics

[610] Yang Zeng, Neimu Jiaoyi Qinquan Zeren de Yinguo Guanxi [Causation of the Tort Liability of Insider Trading], 2014 Faxue Yanjiu [J. Legal Res.], no. 6, at 116, 118.

[611] For example, the 2008 case of Chen Ningfeng v. Chen Jianliang was withdrawn, while the 2009 case of Chen Zuling v. Pan Haishen and the 2012 case of Li Yan v. Huang Guangyu were unsuccessful. For a detailed discussion of these cases, see Huang, supra note 31. On September 30, 2015, the civil insider trading case against Everbright Securities was adjudicated at the Second Intermediate Court of Shanghai and the plaintiffs succeeded in their claims. Chen Nanshan, Guanda Zhengquan Wulongzhi An Yishen Shangsu bei Bohui Panpei Liang Yuangao CNY 33,800 [The Appeal of Everbright Securities Against the Fat Finger Case Was Rejected, and Two Plaintiffs Awarded Compensation of RMB 33,800], Yicai [First Fin. & Econ.] (Feb. 16, 2016), www.yicai.com/news/4750149.html. This is the first successful civil case for insider trading in China, largely because of the high-profile nature of the case and the political economic environment at the time.

on the characteristics of handled insider trading cases, and identify and analyze potential factors that could affect the penalties in administrative and criminal proceedings.

4.3 Conclusion

Despite facing a lot of criticism in light of recent regulatory shortcomings and financial crimes, the U.S. markets are thought to be the best. In terms of improving investor protection and market integrity, the U.S. approach to insider trading regulations trails other recognized jurisdictions. The American regime is still in charge in reality, notwithstanding its shortcomings. The quick response is that there is a fairly strong enforcement and corrective system that is well-accepted, if not supported, by market participants and the general public. Whether this viewpoint continues in the light of the business scandals that have occurred in the United States remains to be seen.

The relevance of regulations that enforce strict standards (such as those pertaining to insider trading) depends on how frequently those rules are actually implemented, as shown by the experiences of numerous nations. Inadequate or ineffective government resources, personnel, and monitoring do little to discourage potential perpetrators. The competent regulator must employ qualified personnel and give them the required equipment in order to carry out monitoring and prosecution in an effective manner. Many countries with stricter legal requirements than the US do not appear to be making this commitment with particularly notable zeal.

A comparison between Chinese and American jurisdictions was made to assess the severity of insider trading enforcement. The comparison's findings are as follows: (i) Based on the number of insider trading defendants multiplied by the size of its securities markets, China has the highest level of enforcement intensity. (ii) In terms of the type and frequency of sanctions imposed, custodial sentences were given to 18.5% of defendants in China, which is comparable to the rate in the United States; punitive pecuniary sanctions are the most frequent, being given to nearly all

defendants (97.3%), which is significantly higher than in the overseas jurisdictions; corrective/restorative pecuniary sanctions (disgorgement orders) were given to 53.9% of defendants, which is significantly higher than (iii) In China, jail sentences often last longer (an average of 3.34 years and a median of three years) than in comparable abroad jurisdictions. They have also gotten longer in recent years. (iv) While China's restrictions are generally shorter than those in other foreign countries, they are longer than those in Ontario. (v) Pecuniary sanctions of about CNY 907 million, or roughly USD 141 million, were imposed in China, which is less than the US but significantly more than the other overseas jurisdictions looked at.

The aforementioned conclusion is still true when adjusted for the size of the individual securities markets. Additionally, the average ratio of financial sanctions to illicit proceeds was 311.18%, which is higher than the bulk of the foreign jurisdictions looked at, such as the United States, the United Kingdom, Australia, and Hong Kong, but lower than Singapore and Ontario. As more unlawful proceeds have been generated in recent years in China, there also seems to be a tendency toward imposing financial punishments. (vi) A model created in a comparable study conducted abroad is used to determine the overall severity of the numerous sanctions that have been imposed in China. The overall sanction value in China is the greatest among all jurisdictions, almost four times that of the United States, and is second only to that of the United States. It is also significantly larger than that of the other countries, after being adjusted for the size of the individual securities markets.

CHAPTER FIVE

INSIDER TRADING REGULATIONS; COMPARATIVE ANALYSIS OF PAKISTAN WITH USA: LACUNAS, CHALLENGES & RECOMMENDATIONS IN THE PAKISTANI REGULAROTARY FRAMEWORK

5.1 Introduction

It is a well settled fact that:

> *"The U.S. corporate and legal framework might be acknowledged as an exemplary role model for adaptation in the international corporate culture, to the principles and requirements of different authorities. Included inside this system are issues concentrating on insider trading rehearses. Looking at U.S. law regarding this matter, in any case, uncovers a routine that on occasion neglects to accord reasonable treatment to market members and hinders business sureness. Nations abroad therefore might be not well served by grasping the U.S. model around there. In reality, concerning insider trading guideline, a study of the securities laws of created markets uncovers that these nations have rejected the U.S. approach. Instead of holding fast to an insider trading solution, they started on member equivalent access to material nonpublic data."*[612]

Naturally, it is impossible to compare the capital markets of Pakistan and the United States. However, it is fair to refer to U.S. legislation for the following two reasons: (1) The United States has had insider trading rules in place since 1933, but both the courts and politicians have erred on

[612] M. Steinberg, (1999), International Securities Law – A Contemporary and Comparative Analysis."

multiple occasions. Learning from their mistakes would help us avoid making the same ones in the future, and (ii) for better or worse, Pakistani laws are heavily influenced by American laws. Insider trading is a problem that has spread to many industrialized nations, and the legal framework in Pakistan will be analyzed in order to determine how well it has been applied by evaluating cases that have been brought before the courts. By examining cases that occurred on an international level involving Raj Rajaratnam, the billionaire founder of the Galleon hedge fund, one of the most contentious and widely criticized hedge funds, it will be possible to compare the legal frameworks of Pakistan and the United States with regard to insider trading and highlight the benefits and drawbacks of each. Additionally, it will be determined whether Pakistan would profit from incorporating specific elements of the American legal system, and if so, which elements might help Pakistan improve its regulatory framework.

5.2 Comparative Analysis of Regulation of Insider Trading in US with Pakistan

Since primary focus of this thesis is to compare the Pakistani regulatory framework with that of other legal regimes but after going through different regimes it has been observed that almost all the other regimes have copied from the traces of US legal regimes in one way or the other, therefore, it is apprised that it would be better to stick to one US regulatory framework for precedence, however, regulatory framework of some famous countries regarding prohibition of Insider trading is tabulated below for the flavor of readers.

Table 7: Penal Provision regarding Insider Trading in Regulatory Framework of the few famous Countries[613]

Countries [614]	Enforcement Body	Specific Laws	Year	Maximum Fines & Fees	Maximum Prison time	Key points of difference with insider trading laws
United States	Securities and Exchange Commission	Securities Exchange Act of 1934	1934	Civil: Greater of $1 million or 3 times amount of profit Criminal - maximum $5 million	20 years	One of the first countries to institute insider trading laws and is the most developed
China	China Securities Regulatory Commission (CSRC)	Establishment of Securities Companies with Foreign Equity Participation Rules	1993	5 times illegal proceeds	10 years	Catching up to the rest of the world with their regulation
Japan	Financial Services Agency	Financial Markets Abuse Act	1988	JPY 3 million	3 years	Employees can only trade on information

[613] International Journal of Accounting and Financial Reporting ISSN 2162-3082 2013, Vol. 3, No. 1, p.13,14 https://www.macrothink.org/journal/index.php/ijafr/article/viewFile/3269/2976 last accessed on 21.08.2022
[614] Table has been categorized according to the market capitalization in the world

						reported by at least two media sources
United Kingdom	Financial Services Authority	Criminal Justice Act	1980	Unlimited	7 years	
France	AMF or Autorité des Marchés Financiers	Monetary and Financial Code of 2000, Banking and Financial Regulation Act of 2010	1970	EUY 100 million	2 years	Lesser penalties for secondary insiders

Other nations have created complex and specific legislation establishing the prohibitions against insider trading, in contrast to the United States, where the judiciary frequently constructs insider trading law. Compared to the U.S. system, the concept of materiality emphasises the impact of the information on market pricing more. The American standard, which looks at whether the pertinent facts would be important to a hypothetical "reasonable" individual in making her investment decision, has not been generally adopted abroad.[615] For instance, the laws of the following nations, including Ontario[616], Canada, Mexico[617], the United Kingdom[618], France[619], Germany[620], Italy[621],

[615] Basic, Inc. v. Levinson, 485 U.S. 224 (1988).
[616] Ontario Securities Act § l(l) (defining a material fact as a "fact that significantly affects or would reasonably be expected to have a significant effect on, the market price or value of securities [of the subject issuer]").
[617] Securities Market Law art. 16 bis (Mex.).
[618] Criminal Justice Act 1993, c. 36 (Eng.).
[619] Law No. 90-08, J.O., July 20, 1990 (defining privileged information as "any precise non-public information ... which, if made public, might affect the price of the security").
[620] Securities Act § 13
[621] Consolidated Act on Financial Intermediation, art. 180, para. 3. Cf former Law No. 157 art. 3. See Paolo Casella, Italy, in INSIDER TRADING: THE LAws OF EUROPE, THE UNITED STATES AND JA.AN 109, 112-113 (Emmanuel Gaillard ed., 1992).

and Australia[622], focus on how the information affects the market price of the affected security. In fact, only a small number of countries, like Japan[623], follow American policy. Thus, despite some areas requiring judicial clarification, the insider trading statutes in developed markets outside of the United States identify the fundamental terminology and concepts that make up the prohibition. Despite this codification strategy, there are still issues that require legislative or judicial resolution. It is crucial to keep in mind that the two regimes are at such different phases of development, with the American regime having changed significantly over the past eight decades while the regulatory regime in Pakistan is only a little over three decades old.

5.2.1 Regulatory mechanism to curb insider trading

First off, the Securities and Exchange Commission of Pakistan (SECP) is in charge of overseeing the legal framework in place to prevent insider trading in Pakistan. The Securities and Exchange Commission (SEC) is the equivalent of SECP in the United States of America. Both the SECP and the SEC have regulatory and oversight responsibilities within their own legal systems. There is no specific law that has been passed in Pakistan to regulate insider trading, but in March 2001, the Securities and Exchange Commission of Pakistan (SECP) announced the Listed Companies (Prohibition of Insider Trading) Guidelines. In contrast to the United States of America, where insider trading is primarily governed by the provisions of the Securities Exchange Act of 1934, which contains the substantive provisions that would result in a penalty, the purpose of establishing these guidelines is to curtail insider trading to ensure transparency at the Exchanges and to restore investor confidence in the stock market as well as common law.

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[622] Corporations Law § 1002G(1) (setting forth that the information, if it were generally available, "might have a material effect on the price or value of [the subject] securities").
[623] Securities and Exchange Law art. 166, para. 2 (defining material facts as encompassing those facts "which may have significant influence on the invesunent decision of investors").

5.2.2 Breach of a fiduciary duty requirement to fix liability

The next critical factor that needs to be compared between the two jurisdictions is whether or not a breach of fiduciary duty is required in order for insider trading liability to arise. When it comes to establishing culpability for insider trading, fiduciary standards have steadily but gradually declined in the United States. The United States Supreme Court's ruling in Chiarella v. United States, which clearly stated that there was no general duty to disclose material, non-public information or refrain from trading based on the securities laws, was the most significant case that highlighted the requirement for a fiduciary breach. This duty had to result from a special relationship between the trader and the investor. [624] The Supreme Court's decision in the Chiarella Case came to be coined the 'classical theory' of insider trading. In the Pakistani regime, a similar movement away from the breach of a fiduciary duty requirement to fix liability has been observed especially after the amendment of insider trading provision 15A-15E replacing 15A-15B in Securities and Exchange Act, 1969 through Finance Act, 2008. Even after amendment, when we go through the certain case laws, it shows almost no implementation of law in the context of misappropriation theory, rather we see the application of classical theory of fiduciary duty as observed in case of Jehangir Tarin.[625]

5.2.3 Liability of a person traded on the basis of misappropriated information

The responsibility of a person who has traded using misappropriated information is the next crucial component of both regimes that has to be evaluated. The "misappropriation theory" of insider trading is now widely accepted in the United States, according to which it is illegal to trade in violation of a duty of loyalty or confidentiality if a person obtains material non-public information

[624] Chiarella v. United States, 445 U.S. 222 (1980).
[625] Muhammad Hanif Abbasi v. Jehangir Khan Tareen and others, C.P No.36 of 2016 under Article 184(3) of Constitution of Islamic Republic of Pakistan. (2018 PLD 114 SC)

without authorization. In Pakistan, it would appear that the SECP has in fact even gone beyond the parameters of the insider trading theories laid down in the United States of America, especially in view of the 2008 amendments in SEO, 1969. Moreover, by the introduction of Guidelines by SECP[626] it has expanded the civil liability under Regulation 5 to ever connected person person who may have been in receipt of unpublished price sensitive information while criminal liability for associated person under Para 3& 4 of guidelines (2001) & Section 15B of SEO,1969. However, it has been observed in Pakistani cases that the requirement to establish a misappropriation theory out of insider trading regulations has been overlooked by the judiciary which is a matter of grave concern.

5.2.4 Fixing Liability on the basis of 'possession v. use'

Possession v. use, or whether liability for insider trading may be fixed if there is a trade while the insider was in possession of the relevant information, is another significant area of controversy in both the legal systems of Pakistan and the United States. This refers to whether it is necessary to prove that the relevant information was actually used in the trade in order to establish liability. It was decided in the United States that there was no need to establish a link between the pirated information and the trading in securities. Trading securities when "aware" has been construed to indicate doing so "on the basis of" material non-public information. In the Pakistani regime, Regulation 5[627] adopts the 'possession' standard and prohibits an insider from dealing in securities 'while in possession of' unpublished price sensitive information. Both legal systems have a similar liability structure in that they both allow for civil & criminal responsibility. Nevertheless, there are a number of different liability-related elements in American law that are absent from Pakistani

[626] Listed Companies (Prohibition of Insider Trading) Guidelines, 2001
[627] Listed Companies (Prohibition of Insider Trading) Guidelines, 2001

law. In the United States, if someone is found guilty of a "wilful" violation, they could face a fine of up to $5,000,000, a sentence of no more than 20 years in prison, or both. However, if the offender is not a natural person, they could face a fine of up to $25,000,000, [628] as was the case with Raj Rajaratnam, a New York hedge fund manager. [629] It is clear from a comparison of the regulatory systems in Pakistan and the United States of America that the latter is not only more forceful, but has also drastically changed over the past eighty years. of contrast, the regulatory structure of Pakistan is still nascent.

5.2.5 Short Swing Profit Rule & Short Selling; Liability in derivative securities

Short selling[630] and short swing profits[631] are prohibited under Companies Ordinance, 1984.[632] Section 224 of the Companies Ordinance 1984 requires the insiders to report to the Securities and Exchange Commission of Pakistan (SECP), regarding purchases and sales of their own company's

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[628] Section 32(a), Securities Exchange Act, 1934

[629] U.S. v. Rajaratnam, 09 Cr. 1184 (RJH)

[630] Short sale is a way that investors may profit from declining security prices. Short selling involves borrowing a security whose price you think is going to fall from your brokerage and selling it on the open market. Your plan is to then buy the same stock back later, hopefully for a lower price than you initially sold it for, and pocket the difference after repaying the initial loan. For example, let's say a stock is trading at $50 a share. You borrow 100 shares and sell them for $5,000. The price suddenly declines to $25 a share, at which point you purchase 100 shares to replace those you borrowed, netting $2,500. https://www.schwab.com/learn/story/ins-and-outs-short-selling Last accessed June 12, 2021

[631] A profit made by a corporate insider who purchases stock and sells it or sells stock and purchases it within a prescribed period (six months). For example, if an officer buys 100 shares at $5 in January and sells these same shares in February for $6, they would have made a profit of $100. Because the shares were bought and sold within a six-month period, the officer would have to return the $100 to the company under the short-swing profit rule. https://www.investopedia.com/terms/s/shortswingprofitrule.asp,See also https://www.merriam-webster.com/legal/short-swing%20profit last accessed June 12, 2021

[632] Section 223, Companies Ordinance, 1984. *Prohibition of short-selling.* - No director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company, and no person who is directly or indirectly the beneficial owner of not less than ten per cent of the listed equity securities of such company, shall practise directly or indirectly short-selling such securities.

Section 224(1), Companies Ordinance, 1984. *Trading by director, officers and principal shareholders.* - Where any director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company or any person who is directly or indirectly the beneficial owner of more than ten per cent of its listed equity securities makes any gain by the purchase and sale, or the sale and purchase, of any such security, within a period of less than six months, such director, chief executive, managing agent, chief accountant, secretary or auditor or person who is beneficial owner shall make a report and tender the amount of such gain to the company and simultaneously send an intimation to this effect to the registrar and the Commission

securities within a period of less than six months. Any gains by such insiders within six months are made recoverable by the company.[633] It is noteworthy that liability is imposed only if there is a specific intent to violate the statute. A person who fails to comply with the statute because of negligence, perhaps even gross negligence, may avoid penalties prescribed for violation as per Proviso of Section 224[634]. There is criminal liability in case of violation of short selling and swing profits.[635]

By implication, Section 224 states that insider trading is believed to be speculative and manipulative if an insider buys and sells, or sells and buy, securities within six months (any profits from such trading are referred to as "short swing profits"). While it is assumed that an insider held or is holding the shares for investment purposes if such purchases or sells occur with a gap of more than six months. It goes without saying that an insider who trades within six months in a specific situation may do so using any inside information. When compared to an insider who trades with a gap of more than six months, their trading is based on crucial information that is not in the public domain. The six-month bright line test, however, seems to be on firm logical ground given the extreme difficulty in determining whether a trade is based on meaningful non-public inside information. In Pakistan, courts have not yet had to decide whether to apply Section 224 to a specific set of circumstances. If specific changes are not made to the law, court interpretation on a case-by-case basis could have unfavorable effects on both insiders and the investing public. For example, Section 224 specifies that a 10% beneficial holder is liable for the provisions of the

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[633] Section 224(1) above.

[634] Proviso Section 224(1), Companies Ordinance, 1984 which states "Provided that nothing in this sub-section shall apply to a security acquired in good faith in satisfaction of debt previously contracted."

[635] Section 224(4), Companies Ordinance, 1984 states; Whoever knowingly and wilfully contravenes or otherwise fails to comply with any provision of section 222, section 223 or section 224 shall be liable to a fine which may extend to thirty thousand rupees and in the case of a continuing contravention, non-compliance or default to a further fine which may extend to one thousand rupees for every day after the first during which such contravention, non-compliance or default continues.

Section. However, when calculating the six-month period between a buy and sell, or the opposite. The Act does not specify whether the act by which a person acquires 10% of the stock is regarded as a purchase.

In other words, if someone buys 10% of Company A on Day 1 and sells the entire position at a profit on Day 10. Is Company A able to recover this profit? The courts' interpretation of Section 16(b) of the U.S. Securities Exchange Act of 1934—the law that is most comparable to our Section 224—led several American courts, until 1976, to hold that the gains were receivable. The U.S. Supreme Court overturned this reasoning in Foremost Mckesson v. Provident Securities,[636] ruling that in a purchase-sale sequence, a 10% beneficial owner is only required to account for profits if he was a beneficial owner prior to the acquisition. In 1991, relevant U.S. statute was appropriately published. It cannot be presumed that a person would have any opportunity to learn important non-public information about the corporation prior to becoming a 10% shareholder, according to the U.S. Supreme Court's decision's persuasive justification.

It is therefore proposed that Section 224 of the Companies Ordinance be changed to reflect the fact that, for the purposes of discharging profits under Section 224, a transaction by which a person acquires 10% of the stock will not be regarded as a purchase unless the person is also an insider (e.g., a director, chief executive, etc.). In the same way, the law has to be made clear that insiders (other than a 10% holder) who participate in a transaction involving the securities of the issuer after they have ceased to be insiders may offset that transaction with another that took place when they were insiders. The justification for this is that since the initial purchase or transaction took place when they were insiders, they may have had access to secret information. Such insiders should not be permitted to resign from their positions in order to profit from sales and purchases,

[636] 423 U.S. 232 (1976)

or from the simultaneous buying and selling of the company's stock, within a six-month period. When trading by insiders involves the exercise or conversion of derivative securities, the interpretation of Section 224 may be difficult to understand. Should the conversion of Class B Stock into its underlying Class A Stock, for instance, be regarded as a purchase or sale of the Class A Stock? Judges in the United States have been mired in this legal dilemma for years due to the absence of statutory explanation. The statute stating that the exercise or conversion of a derivative security constituted neither a purchase nor a sale was only officially promulgated in 1991.[637] Based on the idea that owning derivative instruments is essentially the same as owning the underlying equity securities, this decision was made. The value of derivative securities is directly correlated with the value of the underlying security for the purpose of calculating short swing liability.

In Seinfeld v. Hospital Court, [638] a U.S. District Court states that the judicial rule that treats exercise as a purchase under Section 16(b) cannot bear close examination. A call option gives the owner the ability to buy the underlying stock at a specified price. If the stock price rises later and the person exercises the option before selling the stock, the profit he makes represents the price change between the time he originally bought the option and the time he sold the stock, not between the option's exercise date and the stock's later sale. The courts have erred because they have treated the interim event—the exercising of the stock option—as a separate acquisition. That is untrue. The choice to actually exercise the option does not give the option holder the opportunity to make insider profits and does not qualify as a "purchase" under Section 16(b) because he already has the right to buy the stock at a set price.

[637] **17 CFR § 240.16a-4 - Derivative securities,** A purchase or sale resulting from an exercise or conversion of a derivative security may be exempt from section 16(b) of the Act pursuant to § 240.16b–3 or § 240.16b–6(b). as amended at 56 FR 19927, May 1, 1991

[638] 685 F. Supp 1057 (N.D. 111. 1988)

5.4 The Lacunae (Legal issues) in The Pakistani Regulatory Framework

Pakistan, which has a developed securities market, may be aware of these shortcomings since it chose to adopt American insider trading regulations. The plans presumably sought to provide explicit statutory guidance about the insider trading ban. However, Pakistan might not have largely accomplished its goals owing to week oversight and enforcement mechanism which might have been resulted due to vague statutory reforms and lacunae left over in the development of regulatory framework. In actuality, as the possibility of successful utilization decreases, strict restrictions have a considerably lesser deterrent effect. Laws designed to safeguard investors and advance market integrity therefore have no impact if widespread disobedience persists. If rules are not effectively enforced, market participants may decide to break them[639]. However, some of the major flaws and inadequacies are being discussed here as under;

5.4.1 Lack of vital attributes in Insider Information Definition

The definition of insider information is crucial to law that prohibits insider trading. In a research on inside trading regulations across several jurisdictions, the International Organization [640] highlights a few points. According to the IOSCO report, [641] while enacting legislation regarding insider trading, the regulator must primarily address two challenges. These problems are materiality and confidentiality. [642] The concept/notion "material," [643] which is thought to be a

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[639] Bernard Black, The Core Institutions That Support Strong Securities Markets, 55 Bus. LAW. 1565,1576- 78 (2000); Marc I. Steinberg, Emerging Capital Markets: Proposals and Recommendations for Implementation, 30 INT'L LAW. 715, 723-25 (1996)
[640] International Organization of Securities Commissions (IOSCO)
[641] IOSCO report on Insider Trading legislation" Insider Trading how Jurisdiction regulate it" by International Organization of Securities Commissions available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf (Last accessed February, 2016).
[642] Francis J. Burke, Jr, Steptoe & Johnson, "Insider Trading Securities Violations", ABA Section of Litigation 2012 Corporate Counsel, CLE Seminar (2012) available athttp://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2014_women/written_materials/4_1_insider_trading_securities_violatons.authcheckda m.pdf last accessed on 20th March, 2022
[643] See Section 130 of Securities Act, 2015

crucial component of the definition of inside information, is absent from the aforementioned regulation. Additionally, the statute contains no references to precise or detailed information. There is no indication of the breadth, significance, or importance of the information's materiality. Procedures needed to deem information public and the crucial window of time for doing so are additional major challenges related to insider trading. This legal system does not solve any of these problems.

Confidentiality and materiality can both be seen as components of the notion of "Inside Information." For easier comprehension, these have been reduced to more basic categories as shown in the diagram below. Both of these components have particular details that require further analysis. Beyond the Securities Act of 2015, the IOSCO norms of legislation and those of other international jurisdictions are even more stringent.

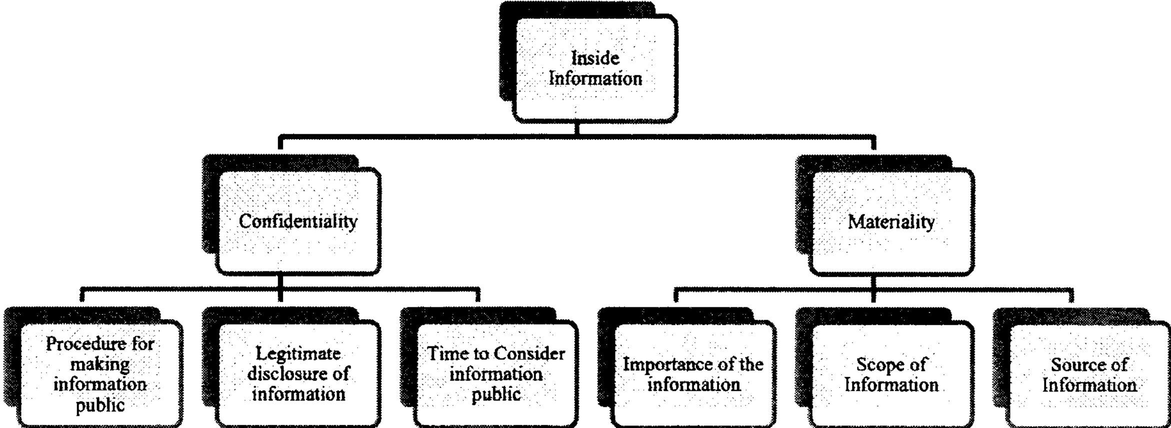

Figure 5.4.1: Elements of Inside Information Definition

5.4.2 Non-Exhaustive Legitimate Disclosure of information

Legitimate disclosure of information is a necessary evil. Although this can complicate the efforts to curb and curtail the practices of insider information abuse. Clause 5.6.1 of the Rule Book issued

by the Pakistan Stock Exchange Limited ("PSX")[644] read with Section 96[645] and Section 131[646] deal with legitimate disclosure of information. It is quite astonishing that these provisions deal

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[644] Clause 5.6.1, Rule Book PSX, "5.6.1. DISCLOSURE OF PRICE-SENSITIVE INFORMATION: (a) Every Listed Company shall immediately disseminate to the Commission and the Exchange all price-sensitive information relating to the business and other affairs of the listed company that may affect the market price of its shares in the manner prescribed by the Exchange from time to time. The said information shall be communicated to the Exchange prior to its release to any other person or print / electronic media. The price-sensitive information may include but shall not be limited to: (i) any material change in the nature of business of the company due to technical, strategic, manufacturing, or marketing related changes, opening of new line of business or closure of any existing line of business, either partly or fully; (ii) information regarding any joint ventures, merger, demerger, restructuring, acquisition or any material contract entered into or lost; (iii) all decisions of the Board of Directors of the company relating to cash dividend, bonus issue, right issue or any other entitlement or corporate action, buy back of securities or voluntary delisting; (iv) purchase or sale of significant assets, franchise, brand name, goodwill, royalty, financial plan, etc.; (v) any undisclosed revaluation of assets including impairment of assets due to any reason; (vi) delay or loss of production due to strike, fire, natural calamities, major breakdown, etc.; (vii) a major change in borrowings including projected gains to accrue to the company; (viii) issue or redemption of securities or any change in the terms of issued securities; (ix) material change in ownership of the company; (x) any default in repayment, rescheduling or restructuring of loans or breach of loan agreement by the company; (xi) default, delay, rescheduling or restructuring in payment of markup, profit, interest or rent etc., as the case may be and in redemption of principal amount in respect of Debt Securities issued by a Listed Company along with reasons thereof; (xii) change in directors, Chairman, CEO or auditors of the company; (xiii) fraud/default by the company or fraud/default/arrest of its directors, CEO or executives; (xiv) initiation of winding up proceedings against the company or any of its associated/subsidiary company; (xv) non-renewal of license by the Commission or any other relevant licensing authority along with reason(s) of the non-renewal; and (xvi) any other information that is deemed price sensitive information. Explanation: Such information shall be disseminated to the Commission and the Exchange as soon as any decision about above referred matters or any other significant issue is taken by the board or a significant matter requiring disclosure has come into the knowledge of the company's management.

[645] Section 96, Securities Act, 2015, 96. Disclosure of price sensitive information.— (1) Except as provided in sub-section (4), a listed company shall disclose to the public forthwith any price sensitive information relating to the company or its subsidiaries which has come to the company's knowledge and which would be material to an investor's investment decision, including information that—

(a) is necessary to enable the public to appraise the position of the company and its subsidiaries;

(b) is necessary to avoid the creation or continuation of a false market in the securities of the company (false market being defined as an uninformed market or one which is based on incomplete information); or

(c) might reasonably be expected to materially affect the market activity and the price of its securities.

(2) A listed company shall ensure that, when disclosing information pursuant to clauses (a) to (c) of sub-section (1), the means it uses for disseminating information are such that it equally, timely and effectively provides access to such information by the holders of the securities of the company and investors.

(3) A listed company meets the requirements of sub-section (1) when information

(a) prospectus (b)

that affects the market or a sector of the market generally is made public in a manner that would be likely to bring it to the attention of persons who commonly invest in securities of a kind whose price or value might be affected by the information.

(4) A listed company may, under its own responsibility, delay the public disclosure of price sensitive information such as not to prejudice its legitimate interests, provided that—

(a) such delay would not be likely to mislead public investors;

(b) any person receiving the information owes the listed company a duty of confidentiality, regardless of whether such duty is based on law, regulations, articles of association or contract; and

(c) the listed company is able to ensure the confidentiality of that information.

(5) In the event that a listed company is also traded or listed on a foreign market or exchange, the listed company shall ensure that where information is released to those markets the same information is released in Pakistan simultaneously.

with the professionals who receive sensitive information in the ordinary business practices and there is no mentioning of specific persons though. A positive thing to note here is that the law backs any disclosure of information to specific persons, by a mandatory public disclosure of information. There are some exceptions required by the business and market practices worldwide. Same exceptions are provided in this section as well. Additionally, listed corporations are required by Sections 131(2) and 131(3) to give the commission a comprehensive list of all individuals connected to the flow of privileged information. Regular updates will be made to this data. The people on this list are expected to acknowledge that they are forbidden from exploiting any inside information for personal gain or from advising or tipping anyone else. The list of disclosure obligations is not all-inclusive. Some fundamental concerns, such as the minimum amount of time to disclose, the method of disclosure, the withholding of insider information, the disclosure of comparable information, and the publication of information on websites, are not properly addressed.[647] Furthermore, the disclosure of trades made by BOD members and other insiders is not standardized. To ensure that the law is applied fairly and justly, defenses, a Chinese wall,[648] and governmental activities must be put in place. [649]

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(6) Without limiting the generality of this section the listed company shall also comply with such further obligations and requirements as may be prescribed.

[646] Section 131, Securities Act, 2015(listed companies should provide a comprehensive list to SECP & PSX of all individuals connected to the flow of privileged information

[647] Ibid., Part X- XI.

[648] A Chinese wall is a business term used to describe a virtual barrier erected to block the exchange of information between departments in a company. The wall is not a physical one, but an ethical one intended to prevent the sharing of information that might lead to ethical or legal violations. A **Chinese Wall**, an inter-organizational ethical barrier to prevent conflicts of interest, was developed in U.S. financial circles in the 1930s.https://www.investopedia.com>articles>Chinesewall last accessed July 22, 2022

[649] For details Bradley J. Bondi, Steven D. Lochie, "The Law of Insider Trading: Legal Theories, Common Defenses, And Best Practices for Ensuring Compliance", New Journal of Law & Business 8, (2012), 151. Available at: http://ssrn.com/abstract=2028459. Last accessed 20th March, 2022

According to Huge et al., the expected profits of an insider fall as low as 50% below the projected profits prior to disclosure as the rate of disclosure per unit time rises. Therefore, information disclosure not only reduces trading costs but also improves market efficiency. [650]

5.4.3 Non-Exhaustive Connected Person Approach

The connected person strategy is used to identify insiders, but because it does not take a comprehensive picture, it excludes temporary and accidental insiders. When prosecuting these insiders, this presents significant challenges. It is found that the insider trading regime tends to define insiders, inside information, and associated concepts broadly. The trading of assets on the Pakistani financial market is about to undergo an online or internet-based revolution. An information connection method with a mix of person connection approaches will be the greatest option for efficiency and simplification.[651]

A balanced strategy with elements of both will be more goal-oriented than one that exclusively focuses on building relationships with people.[652] The main concern in this strategy will be compiling a list of all potentially related individuals and selecting exemptions carefully. [653] This strategy has been employed by certain governments to address this problem.[654]

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[650] Steven Huddart, John S. Hughes and Carolyn B. Levine, "Public Disclosure and Dissimulation of Insider Trades", Econometrica 69, no. 3 (May,2001):665-681, available at http://www.jstor.org/stable/2692205 (Last accessed 25-03-2016)

[651] The Definition Of "Insider" In Section 3 of the Securities Markets Act 1988: A Review and Comparison with Other Jurisdictions, Discussion Paper Series 218, Massey University, School of Accountancy (2003). Available At Http://WwwAccountancy.Massey.Ac.Nz/Publications.Htm

[652] Roman Tomasic, James Jackson and Robin Woellner, Corporations Law: Principles, Policy and Process, 4 th . ed. (Butterworths, Australia :2002) 998.

[653] ibid

[654] Supra 643

5.4.4 Silence over 'tender offer' and 'intermediaries'

A very limited and constrained legal framework is a significant gap in terms of restricted acts. On tender offers and intermediaries[655] for engaging in transactions based on inside information, the 2015 legislation is silent. Additionally, SECP issued the Listed Companies (Buyback of Shares) Regulations, 2019 ("Regulations") which talks about tender offer since Tender offers[656] are a common type of trade and are also vulnerable to insider knowledge exploitation, Pakistani law is completely quiet on this subject. It was noted in one of the well-known cases, AKD Investment Management Limited & Others vs. JS Investments Limited & Others, where the petitioners filed a constitutional petition to stop the private respondent in the case from purchasing or buying back its own shares for cancellation, claiming to be minority shareholders of the respondent no. 1—a publicly listed company—in that case.[657] Tender offers will improve market fairness and legal consistency in the areas where insider trading laws are applicable. [658] A cursory reading of the

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[655] For details see Securities Act 2015, sec. 130-131

[656] Listed Companies (Buyback of Shares) Regulations 2019 ("Regulations"). A buy back is one of the type of tender offer in which the company announces a fixed price at which it will buyback shares from the existing shareholders over the counter 'OTC' instead of open market. **Buyback can be of two types** - tender offer & open market offer.

[657] AKD Investment Management Limited & Others vs. JS Investments Limited & Others CP. D 5016 of 2019. AKD Securities Limited v. SECP (2019 CLD 583 Sindh HC)

[658] Section 88, Companies Act, 2017, stipulates as follows: "88. Power of a company to purchase its own shares. (1) Notwithstanding anything contained in this Act or any other law, for the time being in force, or the memorandum and articles, a listed company may, subject to the provisions of this section and the regulations specified in this behalf, purchase its own shares. (2) The shares purchased by the company may, in accordance with the provisions of this section and the regulations, either be cancelled or held as treasury shares. (Underline added for emphasis.) (3) The shares held by the company as treasury shares shall, as long as they are so held, in addition to any other conditions as may be specified, be subject to the following conditions, namely- (a) the voting rights of these shares shall remain suspended; and (b) no cash dividend shall be paid and no other distribution, whether in cash or otherwise of the company's assets, includingany distribution of assets to members on a winding up shall be made to the company in respect of these shares: Provided that nothing in this sub-section shall prevent- (a) an allotment of shares as fully paid bonus shares in respect of the treasury shares; and (b) the payment of any amount payable on the redemption of the treasury shares, if they are redeemable. (4) The board shall recommend to the members purchase of the shares. The decision of the board shall clearly specify the number of shares proposed to be purchased, purpose of the purchase i.e. cancellation or holding the shares as treasury shares, the purchase price, period within which the purchase shall be made, source of funds, justification for the purchase and effect on the financial position of the company. (Underline added for emphasis.) (5) The purchase of shares shall be made only under authority of a special resolution. (6) The purchase of shares shall be made within a period as specified in the regulations. (7) The proposal of the board to purchase shares shall, on conclusion of the board's meeting, be communicated to the Commission and to the securities exchange on which shares of the company are listed. (8) The purchase of shares shall always be made in cash and shall be out of the distributable profits or reserves specifically maintained for the purpose. (9) The purchase of shares

legislative provision above shows that the Act expressly acknowledges the purchase of a company's own shares for cancellation or holding as treasury shares. However, it is forbidden for underwriters to deal with any price-sensitive information by disclosing it to third parties or intermediaries. [659]

5.4.5 Non-Omission of 'Associated Person' term

As per Listed Companies Prohibition of Insider Trading Guidelines, 2001[660] "associate" means an associate as defined in Securities Exchange Ordinance,1969[661] which says "associate" means any partner, employee, officer or director of a member; while as per Companies Ordinance, 1984 a person who is the owner of or a partner or director in a company or undertaking or, who so holds or controls shares carrying not less than ten per cent of the voting power in a company or undertaking, shall be deemed to be an "associated person".[662] Securities Act, 2015 also illustrates Associate.[663]

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shall be made either through a tender offer or through the securities exchange as may be specified. (10) The company may dispose of the treasury shares in a manner as may be specified. (11) Where a purchase of shares has been made under this section, the company shall maintain a register of shares so purchased and enter therein the following particulars, namely- (a) number of shares purchased; (b) consideration paid for the shares purchased; (c) mode of the purchase; (d) the date of cancellation or re-issuance of such shares; (e) number of bonus shares issued in respect of treasury shares; and (f) number and amount of treasury shares redeemed, if redeemable. (12) Any violation of this section shall be an offence liable to a penalty of level 3 on the standard scale and shall also be individually and severally liable for any or all losses or damages arising out of such contravention."

[659] Regulation 22 of Public Offering Regulations, 2017 states **22. Responsibilities of underwriter.** The underwriter **shall not**,- (ix) be party to or instrumental for passing of unpublished price sensitive information in respect of securities which are listed or proposed to be listed on the securities exchange to any person or intermediary

[660] Regulation 2(b) of Listed Companies Prohibition of Insider Trading Guidelines
,2001

[661] Clause (ab) of subsection (1) of section 2, Securities & Exchange Ordinance, 1969

[662] Section 2(2)(iii) Companies Ordinance, 1984

[663] Section 2(ii) (a), Securities Act, 2015. As per Securities Act, 2015, "associate", in relation to an individual, means (I) that individual's spouse, son, adopted son, step-son, daughter, adopted daughter, stepdaughter, father, stepfather, mother, stepmother, brother, stepbrother, sister or stepsister; (II) any company of which that individual is a director; (III) any company in which that individual or any of the persons mentioned in sub-clause (i), has control of twenty per cent or more of the voting power in the company, whether such control is exercised individually or jointly; or (IV) any employee of that individual

Since we don't find "connected person" or "person deemed to be connected" in SEO, 1969, Companies Ordinance, 1984 and Securities Act, 2015 but we find it in Listed Companies Prohibition of Insider Trading Guidelines, 2001.[664] Moreover, Listed Companies Prohibition of Insider Trading Guidelines, 2001 person deemed to be connected in addition to connected person.[665] The term "Associated Person" must be exchanged with the "Connected Person". The expression "Associated Person" is extra and superfluous. The Guidelines suddenly come up with the definitions of "connected person" and "person deemed to be connected." They do not attempt to redefine the term" associated person." Instead, the Guidelines repeat the definition of the term "associated person." And also repeat the definition of the term "associate" as given in the Ordinance.[666] But this is not the same as "person associated with the company" as that is defined separately in the Ordinance,[667] as described above.

5.4.6 Ambiguity regarding 'unpublished price sensitive information'

First off, the concept of "insider" is noticeably vague. It appears from a straightforward reading of the provision that one of the two elements—(a) proof of a connection with the entity in question (b) a reasonable belief that he had access to confidential, price-sensitive information—must be

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[664] Regulation 2(e) of Listed Companies Prohibition of Insider Trading Guidelines,2001 As per Listed Companies Prohibition of Insider Trading Guidelines, 2001 "connected person" means any person who- (i) is a director, as defined in Companies Ordinance, 1984;[664] or (ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or 2 business relationship between himself and the company and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company;

[665] Regulation 2(k), Listed Companies Prohibition of Insider Trading Guidelines, 2001"person is deemed to be a connected person" if such person (i) is a company under the same management or group or any subsidiary company; (ii) is an official or a member of a stock exchange or of a clearing house of that stock exchange, or any employee of a member of a stock exchange; (iii) is an investment bank, share transfer agent, registrar to an issue, Trustee of Term Finance Certificates, Investment Advisor, Investment Company (closed end mutual fund) or an employee thereof, or, is a member of the Board of Directors of an investment company or a member of the Board of Directors of the Asset Management of an Investment Scheme (open-end mutual fund) or is an employee having fiduciary relationship with the company; (iv) is a member of the Board of Directors, or an employee, of a financial institution as defined in clause (15A) of sub-section (1) of section 2 of the companies Ordinance 1984; (v) is an official or an employee of a self-regulatory organization recognized by the Commission; (vi) is a relative of any of the aforementioned persons; or (vii) is a banker of the company.

[666] Section 2 (a)(b) SE Ordinance, 1984

[667] section 15A, SE Ordinance, 1984

proven in order to qualify and demonstrate insider status within the scope of current regulatory provisions.

On reading the pertinent liability clauses, there are several murky areas regarding the basis on which the insider disclosed unpublished price-sensitive information. In several provisions, the word "on the basis of" was used, but later the phrase "when in possession of" was added. It is not yet clear, though, whether merely having anything in your possession makes you legally responsible for insider trading in Pakistan. The definition of "unpublished price sensitive information" and its range are two more serious concerns that could cause debate. The Pakistan Stock Exchange revised the rules to take into account several ambiguities. However, there seems to be a murkiness in certain provision that provides that 'unpublished' information means information which is not published by the company, or its agents, and is not specific in nature.

5.4.7 Failure to establish 'Mens Rea'

The degree of "mens rea" required to establish an insider trading accusation is the most serious dilemma and gap in our legal system that develops. Given the hidden nature of insider trading, it is particularly difficult for the enforcing agencies to prove the necessary mens rea. A case in point is the AKD Case,[668] where it was determined that in order to establish a breach of the Prohibition of Insider Trading Guidelines, the SECP had to demonstrate an element of "deceit" or "manipulation," which it was unable to do given the circumstances of the case. A "profit motive" was not required to be proven in order to prove insider trading. It was so evident that, even though it is not expressly mentioned in Regulation 3 of Prohibition of Insider Trading Guideline, the element of mental intent cannot be disregarded for the purposes of proving an insider trading case.

[668] AKD Securities Limited v. SECP (2019 CLD 583 Sindh HC)

Due to the ambiguity surrounding the level of proof required to establish the crime of insider trading, it is not just the demonstration of the existence of a malign mental intent that makes implementation problematic.

5.5 Challenges in Implementation of The Regulatory Mechanism

It is crucial to consider one more point before considering the new proposal: why the current situation forbids insider trading. The aforementioned gaps show that the proposed justifications for controlling insider trading, particularly under the existing statutory plan, are weak. Despite the cohesive inconsistencies, insider trading statutes call for stronger accusations and harsher punishments. The extension of risk under the current statute is especially astounding in light of the way that the objectives of the current insider trading hypothesis could be achieved even more precisely by tightening up the rules already in place along with the government's current ban on corporate insiders engaging in short swing trading and short deals.

Understanding the reasons for the current administrative plan's formation is crucial before attempting to rectify its shortcomings. To a limited extent, this question can be answered by examining who benefits from insider trading control. Securities investigators find their employment by looking over publicly available data and attempting to determine whether a certain security speaks to a good venture. Experts have an informational advantage over many people from the contributing open because they have the resources and expertise to obtain unmatched information. The implementation of the regulatory mechanism highlights some significant glitches that need to be plugged. These have broadly been enumerated hereunder:

5.5.1 Materiality; An Obstacle to Enforce Insider Trading Regulations

More than ever, our federal securities laws and regulations, particularly those controlling some types of securities fraud, require substantive change to bring clarity. Specific conduct can only be prohibited with this increased precision, and individuals who violate antifraud rules can only be successfully prosecuted, found guilty, or otherwise held responsible or liable with this increased clarity. Moreover, improved transaction planning for public issuers of securities and their insiders is a result of improved substantive clarity in Pakistan's insider trading regulations. Despite the fact that materiality is defined using the same, well-known legal standard for many different purposes under the various securities laws, the concept of materiality as it is applied in the Pakistani insider trading regulation has produced distinct planning issues for public companies and their insiders. As a result, even though corporate issuers and their directors and officers are aware that they are prohibited from trading while in possession of material, undisclosed information, it is challenging for them to comprehend their legal obligations due to the vagueness of the current legal standard defining what constitutes "material."

The idea that public issuers of securities and their insiders cannot trade in the issuer's securities while in possession of material nonpublic information is at the heart of our country's laws against insider trading. In light of this, whenever a public issuer or one of its insiders possesses undisclosed material information, the issuer or insider must either disclose the information before trading in the issuer's securities or refrain from doing so. This idea, sometimes known as the "disclose or abstain" guideline, is covered in Section 131 and pertains to proper information disclosure. Listed firms are required by sections 131(2) and 131(3) to give the commission a complete list of all individuals connected to the flow of privileged information. The "disclose or abstain" rule's definition of the word "material" is neither statutory nor fixed. Furthermore, this criterion of

materiality is not exclusive to the regulation of insider trading. Instead, the "disclose or abstain" rule's meaning of the word "material" is based on a general legal criterion that judges have created that applies to materiality. [669]

A transaction planner or court must evaluate the likelihood that a reasonable investor (or stockholder) would consider a specific fact or specific information relevant in making an investment decision under this broadly applicable judicial criterion. The investment choice in insider trading involves the acquisition or selling of securities. Alternatively put, a transaction planner or court must consider whether there is a significant chance that the omitted information will affect the "total mix" of market information accessible when establishing the materiality of a specific omitted fact. Therefore, a fact is material if it is substantially likely to be thought important by a reasonable investor when making an investment decision (or if it is substantially likely to change the overall mix of information about the market that is available). A fact is not relevant if it is not substantially likely to be taken into account by a reasonable investor when making an investment choice (or if it is not substantially likely to change the overall mix of information available on the market). The SECP, courts, litigants, and transaction planners all face challenges when interpreting and applying the basic legal norm controlling materiality because of its apparent simplicity. The materiality standard's interpretation and application are very fact-dependent, and they do not necessarily lead to predictable or guaranteed judicial outcomes or planning possibilities. The interpretation and implementation of the legal criterion are also not made more clear by the current regulatory guidelines on materiality. The current legal norm is insufficient for transaction planning and judicial decision-making in the absence of better regulatory guidance.

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[669] For purposes of this dissertation, the term "transaction planner" includes any issuer of securities, any insiders of that issuer, and their respective advisors on any transaction at issue, including without limitation legal counsel.

5.5.3 Inability of SECP as Regulator to Curb Insider Trading

The Commission is in charge of overseeing the securities and any firms on the stock exchange or in other security markets.[670] The Commission was founded as an independent regulatory agency in 1997.[671] The Commission wants to boost both the supply and demand of capital in order to encourage investment, boost industrial output, and create job opportunities. Following the May 2000 stock market crisis, the Commission took a number of steps to regain investors' trust and create a fair, transparent, and effective stock market.[672] The Commission has also adopted a number of regulatory reforms, including the publication of the Insider Trading Guidelines and the Brokers and Agents Registration Rules.[673]

The SECP is thought to have inadequate human resources, which may be a factor in its inability to enforce the market effectively and establish improved regulations.[674] There must be three methods for those who are regulated to hinder the regulator in order for it to "function properly": 1) "by rendering the regulatory organization toothless or disempowering it, either by getting political people to influence it or 2) by removing its authority, so you make it unable to do what it

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[670] Responsibilities of SECP: supervising and monitoring the activities of any central depository and stock exchange clearing house; registering and regulating the working of stock brokers, share transfer agents, portfolio managers, investment advisers or anyone associated with security markets; registering and regulating the investment schemes; regulation of securities industry and related organizations like leasing companies and financial institutions; protecting the market from unfair practices; promoting investors' education and intermediary training; conducting audit of Stock Exchanges and other intermediary organizations; encouraging the development of capital market and corporate sector in Pakistan; regulating acquisition of shares and the merger and takeover of companies; and suggesting reforms in the rules and regulation of companies. https://www.secp.gov.pk/wp-content/uploads/2016/03/PromotersGuideEnglish-new.pdf last accessed March 25, 2022

[671] Before the establishment of SECP (2001) Corporate Law Authority (CLA) attached to Ministry of Industries had been administering the corporate laws since 1981.

[672] Some of the steps taken include implementation of the T+3 settlement system, substantial increase in net capital requirements, stipulation of capital adequacy requirements for brokers, strengthening of margin requirements, appointment of 40 percent independent directors on the boards of the stock exchanges, and initiation of actions to ensure the independence of the Commission's Chief Executive Officer (CEO).

[673] Listed companies (Prohibition of Insider Trading) Guidelines, 2001

[674] In the United States, human resource is often understood as the management of benefits such as payroll etc. However, when these interview participants talk about human resource they are referring more broadly to the term human capital, which covers the quality of talent present in an organization.

is supposed to, and 3) by placing people who are not very capable or honest" in positions of power. A "parliamentary committee" is required to oversee the chairman of the SECP and keep it accountable. The composition of the SECP's policy board, which includes individuals from the finance ministry, is another factor they say "undermines the SECP." [675]

The courts' insufficient assistance to the SECP in carrying out its regulatory duties, which "becomes a basic impediment to good governance," and the dearth of white-collar crime cases emanating from the capital markets were additional often raised concerns. The court system is "poor" and "lethargic," but it is essential to the regulator's success. It will take many years for it to evolve enough to play a sophisticated role in the regulatory regime, but this was the universal view. Our legal system is constrained and unsuited to dealing with white collar crime, and the court system is extremely overburdened. White-collar crime is not prosecuted; the test will come when we attempt to appear in court. Even while the regulator may have a stronger legal foundation in terms of organization, the total number of criminal complaints filed is 3–4. This area continues to be very weak, and new legislation has given the regulator more authority to pursue and punish. However, the SECP has no power to change the justice system. Further, the SECP's "primary role is to prosecute and take action against regulatees, we have not seen enough of that—we have not seen withdrawal of licenses," according to the SECP, is to "take action against regulatees." The fact that "market abuse investigations" have just vanished shows that the SECP is not effectively using its judicial authority. To "ensure there is a level playing field for all stakeholders in the marketplace," they are crucial. The SECP's ability to build Pakistan's markets based on its own

[675] Ali, Syed Irtiza, "Moral Neutralization of Pakistan's Capital Markets: A study of Market Abuse (2017), Wharton Research Scholars, 154, https://repository.upenn.edu/handle/20.500.14332/49197 last accessed April 08, 2022

unique context is hampered by the fact that much of the legislation it creates is imported from western nations without adequate consideration for local context.[676]

Since they are closely regulated by regulatory bodies and accessible to the general public, there are many lawsuits and models developed to detect insider conduct in the global financial sectors. These methods may be useful or ineffective. This is not the case with the Pakistan Stock Exchange, though. The SECP filed a lawsuit about insider trading in 2013 involving Dawood Hercules Corporation Limited (DAWH) and CYAN, two companies connected to a conglomerate corporation, which was looked into for unannounced sales of 800,000 and 500,000 shares in 2011 and 2012.[677] The business was punished with a Rs. 1,000,000 fine and sued.[678] Similarly, in the year 2018, approximately 4 cases, and in the year 2017, approximately 11 cases of insider trading have been filed by SECP in a court of Pakistan.[679] The chances of insider trading inside the Pakistan stock Exchange are high because no or less research and regulations have been established to address this issue in Pakistan or any other part of the world.[680]

5.5.4 Non-shifting from 'person connected approach' to 'information connected approach'

The discourse about the necessity of insider trading regulations, which persisted until the 1990s, has mostly been put to rest.[681] Insider trading restrictions are now widely considered to be necessary, and discussions now center on how insider trading should be handled. Many nations

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[676] Ibid,.
[677] CYAN Limited through CEO v. SECP (2013 CLD 1637 SECP)
[678] Rao, B., Impact of corporate insider on insider trading: Evidence from Pakistan stock exchange, bmij (2021) 9 (1): 295-306, doi: https://doi.org/10.15295/bmij.v9i1.1789
[679] Ibid,.
[680] Ibid, 537
[681] Carlton, Dennis W., and Fischel, Daniel R, 1983, The Regulation of Insider Trading, Stanford Law Review, v. 32, p. 857, Leland, Hayne E., Insider Trading: Should It Be Prohibited?, 1992, The Journal of Political Economy, v. 100, n. 4, p. 859

restrict insider trading using one of two general strategies: a person-connected regime or an information-connected regime.[682] In a person-connected regime, the burden of proving the accused's relationship to the firm is on the prosecution because such individuals are forbidden from trading the company's stock based on confidential and price-sensitive information. The majority of jurisdictions, including Japan and China, run insider trading rules based on this strategy because it is the more established and older system.[683] However, in a system based on information, convictions for insider trading are only predicated on the possession of knowledge that is significant and private. Therefore, it makes no difference how the accused is connected to the contested corporation.[684]

The information-connected regime is actually thought to be a stricter insider trading regulation.[685] In 1991, the Australian government chose to switch from a person-connected system to an information-connected system after significant deliberation. Malaysia and Singapore, two other nations with common law, have made the change as well. After deciding to use the information-connected strategy in a Securities Legislation Bill passed in October 2006, New Zealand followed much later.[686] Other nations, such as China and Canada, were also urged to change from the current person-connected regime to an information-connected regime.[687] Even American courts, who have historically used a person-connected approach to require the proof of a fiduciary

[682] Yeo VCS, 2001, A comparative Analysis of Insider Trading Regulation – Who is liable and what are the sanctions? Unpublished working paper, Nanyang Technological University, Corporations and Markets Advisory Committee (CAMAC), 2001, Insider Trading Discussion Paper

[683] Su Z. and Berkahn MA, 2003, The definition of "insider" in Section 3 of the Securities Markets Act 1988: A review and comparison with other jurisdiction, Discussion Paper Series 218, Massey University

[684] Monetary Authority of Singapore (MAS), Jan 2001, Insider Trading Consultation Document

[685] Securities Commission, Malaysia (SC) Press Release, 1 April 1998, SC Powers Enhanced

[686] New Zealand Ministry of Economic Development, 2002, Reform of Securities Trading Law – Insider Trading Fundamental Review, Discussion Document

[687] Huang Hui, 2005, The regulation of insider trading in China: A critical review and proposals for reform, Australian Journal of Corporate Law, v. 17, p. 281 & Kluver, John, 2005, Executive Director, Australian Government Corporations and Markets Advisory Committee, Insider Trading, paper presented at 2005 CLTA conference & Insider Trading Task Force, 2003, Illegal Insider Trading in Canada: Recommendations on prevention, detection and deterrence

responsibility breach on the part of the accused for breaking Rule 10b-5, have recently changed to the broader misappropriation argument. [688] Then why not Pakistan?

5.5.5 Non-availability of Special Tribunals

Generally speaking, the enactment is intended to prohibit the abuse of specific information about a recorded organization's securities by people connected to that organization who are in control of that information from using it (or encouraging others to use it) to trade in the organization's stock in order to profit or avoid loss. If the Ministry of Finance believes that insider trading in connection with the securities of a registered corporation has occurred or may have occurred, it may request the Insider Dealing Tribunal to investigate the situation and render a decision. Each insider vendor's personality, as well as the amount of any gain realized or loss avoided thanks to insider management. An inquisitorial council must be created for the tribunal managing insiders. It might consider all important and validly probative evidence. In order to assist it in determining if the concern about insider giving has been proven, it is tasked with leading additional requests to strengthen the evidence put up by the gatherings.

5.5.6 Non-signing of MOUs with Counterpart Countries

It is pertinent to mention that Eighteen (18) Memorandums of Understanding (MOUs) have been signed by the China Securities Regulatory Commission with 17 institutions from the 16 nations of Hong Kong, the United States, Singapore, Australia, Great Britain, Japan, Malaysia, Brazil, Ukraine, France, Luxembourg, Germany, Italy, Egypt, the Republic of Korea, and Romania to curb Insider Trading on securities.[689] On the other hand, Pakistan has not signed even a single MOU with any country to curb Insider trading.

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[688] Newkirk T and Robertson, M, 1998, Insider Trading – A U.S. Perspective, 16th International Symposium on Economic Crime, Jesus College, Cambridge, England.

[689] OICU, IOSCO Report on INSIDER TRADING HOW JURISDICTIONS REGULATE IT, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf last accessed March 2023

5.6 Conclusion

The first action taken to solve the problem in Pakistan was the amending of the Finance Act 1995 as Chapter III-A was added to the Securities and Finance Ordinance, 1969. A regulator (SECP) also issued the Listed Companies (Prohibition of Insider Trading) Guidelines 2000 in conjunction with this ordinance. After the stock market fall in 2000, the insider knowledge distribution restriction statute gained attention since it was thought that violations of this rule were the primary cause of the subsequent financial catastrophe. The SECP began reviewing the then-existing legal provision to prevent market manipulation by insider information abuse in the wake of many stock market crashes; the IMF Report (2004) noted the same.[690] But neither of these laws achieved their goals. The provisions of SEO 1969 and the SECP standards clashed in a number of places. Some of these include insider himself not being forbidden from insider selling and person related and person connected discrepancy. As time went on, it became clear that in order to address the shortcomings of the previous legislation, new legislation that is more effective, comprehensive, and exhaustive is required.

The first significant step in this situation was the 2012 changes, which addressed some of the main problems. The most awaited and anticipated Securities Bill 2015 was passed by the national parliament in 2015 despite the fact that it was not perfect like any other law. This piece of legislation is undoubtedly comprehensive. This law deals with several matters about listed securities activities, procedures for issuers, accounting, and assessment; market mediators, prerequisites, accreditation, registration and licenses, authority, and jurisdiction of the commission to issue guidelines, conduct, control and inspect, code of conduct, 46 professional comportment

[690] International Monetary Fund, IMF Country Report No.04/215 Pakistan: Financial System Stability Assessment, including Reports on the observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, and Securities Regulation (July 2004).

procedures, issuance of contract note, and financial autonomy. This Act addressed crucial issues like subscription offers, takeovers, the misuse of insider information, disclosure of prospectuses and other required information, the objectivity of expert testimony, criminal and civil penalties and liabilities, disclosure by publicly traded companies, market manipulation, and the delegation of legislative authority to the regulator.[691]

The 1969 SEO's ambiguities and gaps are to be filled by this legislation. The new legislation aims to fix the legal inconsistencies and rebuild the current system. The law against "Insider Information Abuse" is the main issue here. This new legislation is not all-inclusive in its efforts to prevent the misuse of insider information. When this legislation is compared to current laws around the world, it is clear that some fundamental and important components are lacking. In most jurisdictions, insiders who trade confidential information face civil and criminal consequences, but the aforementioned recent legislation does not include any penalties intended to serve as a deterrent.[692] Intriguingly, SEO 1969 was implemented to curb the misuse of insider knowledge against the backdrop of many stock market crashes. While the Securities Act was established to codify a reorganized legal system and prevent market manipulation. Both laws fall short of international norms and become ineffective tools for limiting the threat.

The SECP's function as a market enabler, however, is at odds with this emphasis on regulation. The second concern raised by the majority of respondents is the caliber and capacity of the SECP's human resource. The criticism is that the SECP's answer to every problem "has been to clamp down" by acting like a "policeman" instead of engaging in constructive reform and development. The economy and shareholders may suffer greatly if insider trading in this sector was ignored in

[691] Part X, Securities Act, (2015) available at http://www.secp.gov.pk/laws/acts/
[692] Securities Act (2015), Part IV, available at http://www.secp.gov.pk/laws/acts/.

order to prevent insider trading and protect shareholders' interests on the Pakistan Stock Exchange, a model must be created.

5.7 Recommendations

This research thesis has actually looked at how insider trading, market manipulation, and other regulations are all handled together in other parts of the world especially US & China. On the basis of the ibid lacuna and challenges in Pakistani Legal Framework pertaining to insider trading regulations, following plausible suggestions are being proposed for the amelioration of insider trading regulatory framework of Pakistan:

1. There is Requirement of comprehensive Provision of Fraud, meaning by, there is a requirement to integrate "Insider Trading to the Market Manipulation and Abuse" in securities trade. Pakistan should handle the problem in a similar fashion. There is a dire need to re-evaluate statutory provisions related to insider trading in a way that integrates the two concepts, comprehensively addresses market abuse, and treats insider trading as a subset of the overall plan akin to China's CSRC 2007 Guide on Insider Trading.

2. The term of 'Associated Person' should be exchanged with 'Connected Person' because in my opinion word associated should be omitted as it falls already in the definition of connected person and persons deemed to be connected. Moreover, the prohibition in guideline No.3 should be replaced from associate with connected and person deemed to be connected in order to clear the vagueness. It is quite strange that in Paragraph 4 of Guidelines, the associates are held liable for criminal/penal action while civil liability is accrued for the connected person which makes the guidelines quite cumbersome especially when it comes to judicious application of mind while adjudication. In consistency with the corporate societies of different countries, the idea of "Associated Person" must be exchanged with the "Connected Person". The expression "associated

person" is extra and superfluous. Truth be told, it is a similar thing as the "connected person." This research recommends that the expression "connected person" be utilized. This will get the law line with the definitions received everywhere throughout the world, particularly where the "connected person" approach has been given significance.

3. There is a dire need to transcend 'Person Connection approach' to 'Information Connection approach'. With such a strategy, it follows that a lot more investors will be held accountable for trading using price-sensitive knowledge that is not accessible to the broader public. Additionally, the information-connected strategy makes it simpler to secure convictions

4. 'Insider' term should be 'Catchall' i.e., it should encompass Insider and Outsider both, notwithstanding they have fiduciary relationship with the source of information or not. Wide-ranging and illustrious must be the words used to describe "INSIDER." The term "insider," especially when used in conjunction with "related individuals," is unclear for all practical purposes. The phrase needs to be well defined in terms of who is considered an insider and what his risk is. Furthermore, the term needs to be defined in a way that separates the true insider from the "tippee." Also, the person who "misappropriates" data and his tippee. The current law is ambiguous regarding these requirements. Additionally, all insiders, misappropriators of data, and their tippees should be subject to criminal liability as well. In fact, almost all international laws impose both financial and criminal penalties on insiders, misappropriators, and their tippees. The current Pakistani legislation imposes financial obligations on everyone, but only "associated individuals" are subject to criminal liability. It is proposed that persons who unlawfully handle internal data face both common obligation and criminal danger.

5. It is sin qua non to Establish a Special Tribunal for Coping with Cases of Insider Trading is proposed in order to establish a free court to deal with instances of insider trading and market abuse on the model of or similar to the Tribunal dealing with insider trading, as established by some advanced states. A person suspected of insider trading may be ordered by the Insider Dealing Tribunal to pay the exchequer an amount not to exceed the amount of any advantage received or loss avoided as a result of his insider trading. The Tribunal may also ask for a penalty from the insider trader that is not more severe than the amount of any gain received by anyone or loss avoided by anyone as a result of the insider dealing.

6. Materiality factor should be cleared since it is necessary to resolve the current ambiguities in the interpretation and application of the current materiality standard in the context of insider trading which cannot be made possible unless: (1) the Pakistani securities trading markets operate fairly and honestly, free from any breach of trust by issuers and their insiders; (2) the protection of investors and promotion of the integrity of the Pakistani securities markets is achieved through the avoidance of fraud, manipulation, and deception in connected transactions; and (3) the Pakistani securities markets are not distorted in any way.

7. Each and every recorded element must be subject to the significant enactment. However, if the executives of those excluded remote elements have agreed to the disclosure requirements of their consolidated ward, it should be assumed that they have consented to the arrangement. The disclosure commitment should apply to all chiefs and senior administrators, including the CEO. The disclosure commitment on these persons should cover any immediate trading and any trading through related gatherings. The disclosure period should be cut from 14 to 2 business days, excepting modifications arising from profit (circulation) re-venture designs, in which case the term should remain at 14 days.

8. It is recommended that Section 224 of the Companies Ordinance, 1984 be amended following the passage of the Future Markets Act, 2016 to effectively reflect the reality that the exercise or conversion of a derivative security is neither a buy nor a sale. Since the conversion or exercise does not signify the purchase or sale of a right that allows for the possibility of profit. In order to calculate an insider's short swing profit, it should not be an occurrence that is compared to another transaction in the underlying equities. The aforementioned explanation of derivative securities in the context of Section 224 must be understood to be quite complex and possibly even perplexing. In order to avoid further complicating the situation, I must also admit that I disregarded a number of additional technical considerations (such as those that arise when exercise/conversion prices are not pre-set). The main goal of bringing it up is to draw attention to the issues that regulators must take into account and update Pakistan's insider trading rules accordingly. There has been a significant amount of litigation about short swing gains in the US due to ambiguous statutes. In order to prevent loss and expenses that investors may incur as a result of litigation that may occur as Pakistan's capital markets become more sophisticated, regulators in Pakistan would be wise to specifically define how to treat short swing profits.

9. Furthermore, it is proposed that Section 223 be amended to prohibit short sales by anybody (regardless of insider status) at a price lower than the most recent proceeding sale. This would prevent individuals from shorting a stock that is already declining, which would increase selling pressure and accelerate the price slide.[693] A number of investors would covertly arrange to sell short shares of a particular firm, driving the price to extremely low levels. They would close off their short bets at a predetermined signal, profiting greatly from the trades.[694] The Securities and

[693] The so-called "BearRaiders" frequently used this strategy, which led to the Great Depression in the United States in the 1930s

[694] See, Widicus and Stitzel, personal Investing (c. Richard D. Irwin, Inc 1980), p. 350

Exchange Commission in the US outlawed short sells at a price lower than the most recent sale following the Great Depression. Only some insiders are prohibited from short selling in Pakistan, but it has been suggested that this limitation be extended to anyone who sells a short position at a price lower than the sale that came right before it. This would stop the price declines brought on by short selling.

10. Un-informed persons must be safeguarded from civil legal liability i.e., if a person who was acquired without their knowledge establishes that the insider who obtained them did not profit immediately or indirectly from the trade, they should not be forced to make good on whatever gains they made or losses they avoided.

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