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A Step towards the Harmonization of the Regulation of Financial Misconduct in BRICS: A Comparison of the Chinese and South African Regimes for the Prohibition of Insider Dealing

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Abstract

With the growing globalization of financial markets comes the need for regulatory convergence as well as standardization of the enforcement of the regulatory environment. Aligning regulatory approaches is crucial in empowering market players to maximize the regulatory benefits provided by foreign jurisdictions and platforms. Attaining that objective necessitates an understanding of the existing regulatory setting by comparing the approaches adopted by different jurisdictions. This article seeks to understand the strategies and mechanisms adopted by two of the most strategically linked nations within the BRICS bloc, China and South Africa, regarding insider trading regulation and its enforcement. What emerges suggests that, while these jurisdictions recognize the threat that insider trading poses to the integrity of their markets, they face serious resourcing and political challenges that weaken regulatory and enforcement efforts aimed at reducing incidence of the offence.

Keywords

Globalization, harmonization, enforcement, insider trading, China, South Africa, regulation, securities

INTRODUCTION

Recent decades have witnessed increased globalization of financial markets.[1] More particularly, the cross-border establishment of financial players has

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1 See for instance J Black "Restructuring global and EU financial regulation: Character, capacities and learning" in E Wymeersch, KJ Hopt and G Ferrarini (eds) *Financial Regulation and Supervision: A Post-Crisis Analysis* (2012, Oxford University Press) 3 at 9; K Alexander "Global financial standard setting: The G10 committees, and international economic law" (2009) 34/3 *Brooklyn Journal of International Law* 861; E Helleiner "Explaining the globalization of financial markets: Bringing states back in" (1995) 2/2 *Review of International Political Economy* 315; RM Stulz "The limits of financial globalization" (2005) 60/4 *Journal of Finance, American Finance Association* 1595; R Balakrishnan "Extraterritorial obligations,

culminated in "markets without a state".[2] The interdependence and transnationalization of financial structures have been effected through various vehicles but typically via myriad trading blocs and international economic integration arrangements. Such interconnectedness has, among other things, empowered market players to maximize the regulatory benefits provided by foreign jurisdictions and platforms. More beneficially it has enabled "parties that feel overburdened by their government's system of regulation to reconfigure their business to slide into the jurisdiction of a more advantageous supplier of regulatory services".[3] Nonetheless, in a setting where there are global linkages comes the need to craft entry and exit mechanisms for foreign players. It also means that regulatory and enforcement mechanisms are usually put to the test and remodelled by changes in the net regulatory problems that emerge from jurisdictional competition for financial services.[4] Failure to standardize regulations results in regulatory competition, which can be exacerbated, especially in an environment where there are information asymmetries between the various interconnected jurisdictions. Such an environment then engenders, inter alia, systemic vulnerabilities and negative spillovers.[5] Worse still, regulatory competition might result in regulatory arbitrage,

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financial globalisation and macroeconomic governance" in A Nolan (ed) *Economic and Social Rights after the Global Financial Crisis* (2014, Cambridge University Press) 164; MA Kose, E Prasad, K Rogoff and S Wei "Financial globalization: A reappraisal" (2009) 56/1 *IMF Staff Papers, Palgrave Macmillan Journals* 8; O Issing "The globalisation of financial markets" (12 September 2000), available at: <http://www.ecb.europa.eu/press/key/date/2000/html/sp000912_2.en.html> (last accessed 8 July 2018); MD Knight "Globalisation and financial markets" (speech at the 34th Economic Conference of the Austrian National Bank, Vienna, 22 May 2006), available at: <http://www.bis.org/speeches/sp060522.htm> (last accessed 8 July 2018).

2 In fact, scholars have coined the term "glocalization", to denote the globalization and localization of the topography of financial markets. See for instance B Grossfeld "Comparatists and languages" in P Legrand and R Munday (eds) *Comparative Legal Studies: Traditions and Transitions* (2003, Cambridge University Press) 154 at 188. See also M Andenas "Harmonising and regulating financial markets" in MH Andenïs, MT Andenïs and CB Andersen (eds) *Theory and Practice of Harmonisation* (2012, Edward Elgar) 1.

3 K Alexander and R Dhumale *Research Handbook on International Financial Regulation* (2012, Edward Elgar) at 47. See also AN Licht "International diversity in securities regulation: Some roadblocks on the way to convergence", available at: <http://www.law.harvard.edu/programs/corp_gov/papers/No233.98.Licht.pdf> (last accessed 8 July 2018); M Kenny "Standing surety in Europe: Common core or Tower of Babel?" (2007) 70/2 *Modern Law Review* 175.

4 See generally Alexander and Dhumale, id at 46.

5 See for instance KM Meessen, M Bungenberg and A Puttler *Economic Law as an Economic Good: Its Rule Function and its Tool Function in the Competition of Systems* (2009, Walter de Gruyter) at 31; R Kulms "European corporate governance after five years with Sarbanes-Oxley" in FS Kieff and TA Paredes (eds) *Perspectives on Corporate Governance* (2010, Cambridge University Press) 413 at 457–58; J Jordana and D Levi-Faur *The Politics of Regulation: Institutions and Regulatory Reforms for the Age of Governance* (2004, Edward

where jurisdictions that introduce tougher regulation ultimately suffer "first mover disadvantage" as financial market players move elsewhere.[6] It is these perceived risks that detractors have cited as outweighing the touted benefits of economic blocs.[7]

To remedy that, there have been increased calls for the harmonization of financial regulation, it being argued that aligning regulatory standards across members trading in financial services forms the basis of market integration.[8] Furthermore, a shared goal of implementing a harmonized securities regulatory architecture is given impetus by the recognition that lack of co-ordination can result in policy and regulatory leakages, setbacks that are likely to hinder the attainment of efforts aimed at building consumer and investor confidence.[9] Sadly, however, endeavours towards regulatory harmonization have been left mostly to market forces[10] and further, "[w]ith few exceptions, there is little theoretical discussion of institutionalized international cooperation for harmonizing securities regulation regimes. The bulk of the literature on these aspects invariably revolves around the practical and administrative aspects of regulatory cooperation. While these aspects are important for their own sake, they leave unanswered the underlying issues of substantive regulatory diversity."[11]

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Elgar) at 108; WW Bratton and JA McCahery "Regulatory competition, regulatory capture, and corporate self-regulation" (faculty scholarship paper no 1365, 1995).

6 Licht "International diversity", above at note 3.

7 These include JN Bhagwati "The capital myth" (1998) 7/3 *Foreign Affairs* 7; J Eatwell "International financial liberalization: The impact on world development" (UN Development Programme discussion paper no 12, 1997); Kose et al "Financial globalization", above at note 1; D Rodrik "Trading in illusions" (2001) *Foreign Policy* 55; K Rogoff "Can international monetary policy cooperation be counterproductive?" (1985) 182 *Journal of International Economics* 54.

8 C Jordan and G Majnoni "Financial regulatory harmonization and the globalisation of finance" (World Bank policy research working paper 2919) at 2; Alexander and Dhumale *Research Handbook*, above at note 3 at 46.

9 N Dobos, C Barry and T Pogge *Global Financial Crisis: The Ethical Issues* (2011, Palgrave) at 172.

10 See generally Jordan and Majnoni "Financial regulatory harmonization", above at note 8 at 2. For other factors that allegedly might bring about convergence of regulatory approaches, see for instance AC Ciacchi "Non-legislative harmonisation of private law under the European Constitution: The case of unfair suretyships" (2005) 13 *European Review of Private Law* 285; AI Ogus "Competition between national legal systems: A contribution of economic analysis to comparative law" (1999) 48 *International & Comparative Law Quarterly* 405; JHM van Erp "European private law: Post-modern dilemmas and choices" (1999) 3/1 *Electronic Journal of Comparative Law*, available at: <http://www.ejcl.org/31/art31-1.html> (last accessed 8 July 2018).

11 Jordan and Majnoni, id at 12. See also U Geiger "The case for the harmonization of securities disclosure rules in the global markets" (1997) *Columbia Business Law Review* 241; JP Trachtman "Unilateralism, bilateralism, regionalism, multilateralism, and functionalism: A comparison with reference to securities regulation" (1994) 4 *Transnational Law & Contemporary Problems* 69.

That scenario typically results in a messy and counter-productive regulatory interaction stemming from policy misalignment between the countries in the coalition. The recent financial crisis has provided crucial lessons in this regard; for instance, it has been shown that "[h]armonization … can increase control by a group of countries over another's regulatory regime and thus reduce the vulnerabilities that independencies create. Further, as the handling of the crisis demonstrated, unilateral actions by one country can have negative spillover effects on others, which coordinated action can avoid."[12] Such is the importance of regulatory convergence. Nonetheless, as a precursor or sine qua non to the accomplishment of that mission, there must be an appreciation of the laws as they obtain in the different states.[13]

To kick-start efforts to eliminate vulnerabilities and attain coherence in the financial regulatory framework within the BRICS bloc,[14] this article attempts to identify and understand the commonalities and practical differences in approaches towards the regulation of insider dealing[15] between two of the

12 Black "Restructuring global and EU financial regulation", above at note 1 at 9.

13 See generally S Banakas "The contribution of comparative law to the harmonisation of European private law" in A Harding and E Orucu (eds) *Comparative Law in the 21st Century* (2009, Kluwer Law International) 179; J Gordley "Comparative legal research: Its function in the development of harmonized law" (1995) 43 *American Journal of Comparative Law* 555; F Scheinder "How, if at all, can comparative legal studies make a contribution to the on-going debate on legal integration within the European Union?", available at: <fredericschneider.free.fr/Essay_Integration_Vertragsrecht.doc> (last accessed 8 July 2018); P Wright-Carozza "Organic goods: Legal understandings of work, parenthood, and gender equality in comparative perspective" (1993) 81 *California Law Review* 531; K Schweigert and H Kötz *An Introduction to Comparative Law* (3rd ed, 1998, Oxford University Press).

14 The BRICS (Brazil, Russia, India, China and South Africa) bloc comprises leading regional and political emerging economies. South Africa is included as a representative of African countries. See European Parliament Directorate-General for External Policies "The role of BRICS in the developing world" (2012), available at: <http://www.ab.gov.tr/files/ardb/evt/1_avrupa_birligi/1_9_politikalar/1_9_8_dis_politika/The_role_of_BRICS_in_the_developing_world.pdf> (last accessed 8 July 2018); and S Mathur and M Dasgupta (eds) "BRICS: Trade policies, institutions and areas of deepening cooperation" (Centre for World Trade Organization Studies, 2013), available at: <http://wtocentre.iift.ac.in/FA/Brics.pdf> (last accessed 8 July 2018).

15 Also known as insider trading. In brief, this offence is committed when one trades in securities while in possession of material non-public information. For a full discussion of insider dealing and the debate surrounding its proscription, see for instance SM Bainbridge "Insider trading: An overview" (24 October 1998), available at: <https://ssrn.com/abstract=132529> (last accessed 8 July 2018); SM Bainbridge "The law and economics of insider trading: A comprehensive primer" (February 2001), available at: <http://papers.ssrn.com/paper.taf?abstract_id=261277> (last accessed 8 July 2018); E Avgouleas *The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis* (2005, Oxford University Press); H Chitimira "A historical overview of the regulation of market abuse in South Africa" (2014) 17/3 *Potchefstroom Electronic Law Journal* 937; D Botha "Control of insider trading in South Africa: A comparative analysis" 1991 *South African Mercantile Law Journal* 1; R Jooste "A critique of the insider trading provisions of the 2004 Securities Services Act" 2006 *South African Law Journal* 437; SM Luiz "Insider trading

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main trading partners, China and South Africa. A comparison of this nature is potentially laudable for a number of practical reasons. First, it has been shown that a comparison of jurisdictions presents or can have transformative effects, the net effect of which is likely to be an accelerated pace of financial globalization, which in turn results in increased capital flows, expansion of financial intermediaries and increased foreign listings.[16] Likewise, a comparison of this nature lays the foundation upon which "recognition of ways in which our own framework is deficient or flawed"[17] can be accomplished. It can also act as a guide or model for legal policy reform activities,[18] and it is hoped that it will result in the equal treatment of players within BRICS. The choice of South African and Chinese regimes for this purpose is premised on purely pragmatic considerations that combine to make an interesting area for an examination of the scope and application of insider trading laws. These factors include the fact that, even though it is the smallest economy in the BRICS grouping,[19] South Africa nonetheless occupies a strategic position on the continent.[20] With an effective stock exchange and a robust regulatory environment for the financial services sector, South Africa is better placed to attract foreign investors who eventually expand their investment activities into the rest of the continent. It is no wonder therefore that South Africa is regarded as the gateway to the rest of the African continent.[21]

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regulation: If at first you don't succeed …" (1999) *South African Mercantile Law Journal* 136; H Kawadza "Extra-judicial enforcement of securities regulation and the public interest theory: A South African perspective" (2015) 1 *Speculum Juris* 2.

16 Jordan and Majnoni "Financial regulatory harmonization", above at note 8; A Cahn and DC Donald *Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA* (2010, Cambridge University Press) at 4–5; A Adarov and R Tchaidze *Development of Financial Markets in Central Europe: The Case of the Ce4 Countries* (2011, International Monetary Fund) at 7; N Bayraktar "Measuring relative development level of stock markets: Capacity and effort of countries" (2014) 14/2 *Borsa Istanbul Review* 74; F Allen and D Gale *Comparing Financial Systems* (2000, MIT Press) at 3–25.

17 MA Glendon, PG Carozza and MW Gordon *Comparative Legal Traditions: Text, Materials, and Cases on Western Law* (2007, Thomson / West) at 15.

18 K Zweigert and H Kotz *An Introduction to Comparative Law* (3rd ed, 1996, Oxford University Press).

19 See for instance European Parliament Directorate-General for External Policies "The role of BRICS", above at note 14; T Hult "The BRICS countries" (2009) 3/4 *Global Edge Business Review* 1 at 1–2.

20 South Africa's importance is best summarized by Leslie Maasdorp, vice-president of the BRICS Development Bank who, in respect of South Africa's standing in the BRICS formation and in particular in respect of the newly formed BRICKS Bank, avers that "[w]e are not just South Africa, we are broadly representative of an entire continent that will be an important part of the future of this institution … South Africa is the gateway to Africa". See C Barron "Hope or hoopla for BRICS's new bank" (5 July 2015) *Sunday Times* at 19.

21 See generally E Pickworth "Foreign investors divided on SA" (31 March 2014) *Business Day*; T Fundira "A glance at Africa's engagement with the BRICS" (2012) 1/1 *Bridges Africa* 23; L Donnelly and C Benjamin "China and SA cement relationship" (22 March 2013) *Mail and Guardian*; Barron, ibid; A Laverty "Globalization in emerging markets: How South Africa's

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Likewise, being South Africa's[22] as well as Africa's major export and import market and largest trading partner,[23] China has had an immense impact on the continent. So deeply-rooted and dominant are China's influence and intentions in Africa that it has managed to craft a Sino-African policy;[24] on that basis it is only proper that China be subjected to this discussion. Equally important is the fact that China and South Africa have increasingly embarked on a mission to expand their strategic partnership in the financial markets.[25]

THE INSIDER TRADING REGULATORY FRAMEWORK

Although their institutional and regulatory regimes for regulating and supervising securities are fairly young, the approaches adopted by China and South

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relationship to Africa serves the BRICS" (2 May 2011), available at: <http://theafricanfile.com/public-diplomacy/international-relations/globalization-in-emerging-markets-united-how-south-africa%E2%80%99s-relationship-to-africa-serves-the-brics/> (last accessed 8 July 2018).

22 See for instance C Landsberg and J-A van Wyk *South African Foreign Policy Review* vol 1 (2012, African Books Collective) at 113; V Lo and M Hiscock *The Rise of the BRICS in the Global Political Economy: Changing Paradigms?* (2014, Edward Elgar) at 178–83; FY April and G Shelton *Perspectives on South Africa-China Relations at 15 Years* (2015, Africa Institute of South Africa) at 105; UN *Economic Development in Africa Report 2010: South-South Cooperation - Africa and the New Forms of Development Partnership* (2014, UN Publications) at 30; L Thrall *China's Expanding African Relations: Implications for US National Security* (2015, Rand Corporation), chaps 2–3.

23 See for instance Fundira "A glance at Africa's engagement", above at note 21; DJ Muekalia "Africa and China's strategic partnership" (2004) 13/1 *African Security Review*, available at: <https://www.tandfonline.com/doi/abs/10.1080/10246029.2004.9627264> (last accessed 8 July 2018); April and Shelton, ibid; Barron "Hope or hoopla", above at note 20; C Alden *China in Africa: Partner, Competitor or Hegemon?* (2007, Zed Books) at 8; J Wang and A Bio-Tchane "Africa's burgeoning ties with China" (March 2008) *IMF Finance & Development* 44; P Drummond and EX Liu "Africa's rising exposure to China: How large are spillovers through trade?" (International Monetary Fund, 17 December 2013) at 4–21; L Hanauer and LJ Morris *Chinese Engagement in Africa: Drivers, Reactions, and Implications for US Policy* (2014, Rand Corporation) at 5–55.

24 See A Crotty "Getting China in step with Africa's beat" (7 June 2015) *Sunday Times Business* at 3.

25 See for instance F Crul "China and South Africa on their way to sustainable trade relations" (29 May 2013), available at: <http://www.tralac.org/publications/article/4196-china-and-south-africa-on-their-way-to-sustainable-trade-relations.html> (last accessed 8 July 2018); E Patel (minister of economic development, Republic of South Africa) "Defining the strategic partnership between South Africa and China" (23 November 2009), available at: <http://www.economic.gov.za/communications/speeches/minister/2009/116-defining-the-strategic-partnership-between-south-africa-and-china> (last accessed 8 July 2018); P Draper "Rethinking the (European) foundations of sub-Saharan African regional economic integration: A political economy essay" (Organisation for Economic Co-operation and Development Centre working paper no 293).

Africa to create robust, liquid and well-regulated securities markets have evolved rapidly over the years.

China

Within China, it has long been recognized that "insider trading has hurt the interests of retail investors for decades"[26] and there have been numerous demands that "regulators must address the issue to allow the country's capital market to flourish".[27] To its credit, and maybe having learned from the experience of more mature markets and regulators, China responded rapidly to the problem by launching its prohibition on insider trading at almost the same time that the government founded the Chinese stock market.[28] In essence therefore, the coming into effect of the insider trading regime is regarded as a culmination of the country's economic development.[29] Nonetheless, that regulatory regime is essentially transplanted from more mature markets, mainly that of the USA.[30] Nevertheless, a peculiar characteristic of the Chinese

26 G Changxin "New CSRC chairman signals crackdown on insider trading" (2 December 2011) *China Daily*, available at: <http://chinadailyapac.com/article/new-csrc-chairmansignals-crackdown> (last accessed 8 July 2018). See also GT Jan Yang "An insight into insider trading in greater China" (2010) 1/1 *Maryland Series in Contemporary Asian Studies* 1; H Shuli "China must crack down on rampant insider trading" (18 June 2014) *South China Morning Post*; H Huang "Insider trading and the regulation on China's securities market: Where are we now and where do we go from here?" (2012) 5 *Journal of Business Law* 379.

27 Changxin, ibid. See also CP Montagano "The global crackdown on insider trading: A silver lining to the 'Great Recession'" (2012) 19/2 *Indiana Journal of Global Legal Studies* 575. It is also reported that the prevalence of insider trading in China is such that it dominates 80% of all securities cases. See H Huang "The regulation of insider trading in China: A critical review and proposals for reform" (2005) 17 *Australian Journal of Corporate Law* 281. See also JH Thompson "A global comparison of insider trading regulations" (2013) 3/1 *International Journal of Accounting and Financial Reporting* 1.

28 See generally H Huang "An empirical study of the incidence of insider trading in China" (paper presented at the Second Annual Conference on Empirical Legal Studies, New York, 9–10 November 2007).

29 In China the definition of conduct deemed insider trading [*neimu jiaoyi*] is tied to the birth of the Shanghai and Shenzhen stock markets in the early 1990s. For a comprehensive discussion of China's economic reforms and how they have impacted the evolution of the regulation of financial crime and insider trading in particular, see for instance SC Thomas and C Ji "Privatizing China: The stock markets and their role in corporate reform" (2004) 31/4 *China Business Review* 58; R Yang and W Mo *A Perspective View on Chinese Securities Market, in China* (1997, The Chinese University of Hong Kong) at 6; Huang "The regulation of insider trading", above at note 27; C 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; Y Wei "The development of the securities market and regulation in China" (2005) 27 *Loyola of Los Angeles International and Comparative Law Review* 479; Z Chen *Wind and Cloud on the Securities Markets in China* (2nd ed, 2000, Shanghai Transportation University Press) at 91.

30 It has been argued that: "Instead of spending time and resources developing a new regime, China adapted the most effective and efficient regulations and enforcement

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regime for the proscription of insider trading is the fact that there is no distinct piece of legislation governing the prohibition.[31] Of the existing piecemeal rules, noteworthy proclamations include the Provisional Measures for Regulating Securities Companies (promulgated in October 1990 and issued by the People's Bank of China) article 17 of which states that "securities companies are prohibited from engaging in market manipulation, insider trading, and other types of misconduct that yield profits by unlawfully affecting the market".[32] Likewise, the China Securities Regulatory Commission (CSRC)[33] promulgated Provisional Measures for the Prohibition of Securities Fraud in September 1993, which focused on proscribing typical fraudulent securities activities, including insider trading. However, with the current Securities Law of the People's Republic of China (Securities Law),[34] the country has not only come up with a more comprehensive regulatory structure but has also

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techniques from the history of US insider trading laws": Montagano "The global crackdown", above at note 27 at 599. See also H Shen "A comparative study of insider trading regulation enforcement in the US and China (2008) 9 *Journal of Business & Securities Law* 41; JA Kehoe "Exporting insider trading laws: The enforcement of US insider trading laws internationally" (1995) 9 *Emory International Law Review* 345; H Huang "The regulation of insider trading in China: Law and enforcement" in SM Bainbridge (ed) *Research Handbook on Insider Trading* (2013, Edward Elgar) 303. For instance art 47 of the Securities Law of 2006 draws from sec 16(b) of the US Securities and Exchange Act of 1934. Likewise, China has adopted the US concepts of temporary or constructive insiders, that is, groups of persons who are nominal outsiders but nevertheless subject to the prohibition. These are people who trade in securities on the basis of being privy to information by virtue of their statutory duties or private contracts; these include lawyers, accountants and consultants, as well as staff involved in registering securities.

31 See generally J Bian *China's Securities Market: Towards Efficient Regulation* (2014, Routledge) at 132; Z Liu and M Wang "Insider trading in China" in PU Ali and GN Gregoriou (eds) *Insider Trading: Global Developments and Analysis* (2008, CRC Press) 157 at 157.

32 H Huang *International Securities Markets: Insider Trading Law in China* (2006, Kluwer Law International) at 19. See also Z Liu and M Wang "Insider trading in China" in PU Ali and GN Gregoriou (eds) *Insider Trading: Global Developments and Analysis* (2008, CRC Press) 157.

33 The CSRC is the sole authority with the aim of supervising the entire Chinese securities market. Its objectives are to ensure that the market is open, fair and just. It also seeks to protect the legal rights of all investors, and aims to engender the healthy growth of the Chinese capital market. For more of these goals, visit CSRC at: <http://www.csrc.gov.cn/pub/csrc_en/about/> (last accessed 8 July 2018). It seeks to accomplish its goals through policies and legislation on securities and futures markets. It also supervises domestic securities firms as well as the issue, listing, trading, custody and settlement of securities. Likewise, it monitors the conduct of market players. However, this regulatory document was repealed in 2008.

34 Promulgated by the Standing Committee of the National People's Congress on 29 December 1998, amended on 27 October 2005, effective 1 January 2006, available at: <http://www.china.org.cn/english/government/207337.htm> (last accessed 6 September 2018). To date, the Securities Law has been amended three times (in 2004, 2005 and 2013). The 2005 amendment was the most profound.

sought to generate uniformity in securities market regulation.[35] Article 75 of the Securities Law outlines unpublished information relating to a business that would be deemed to constitute inside information.[36] Article 74 of the Securities Law gives an account of people who may be considered to be insiders and who cannot, before information is made public, disclose, purchase or sell securities of the relevant company.[37] It also outlaws making suggestions to other persons ("tipping") to trade in those securities. Under article 76 of the Securities Law, those individuals include anyone who might have obtained such inside information illegally. Equally notable is the fact that the definition of an insider under article 74 captures not only natural persons but also "other persons" such as juristic persons and other business entities.[38] Loss to any investor as a result of the contravention of that prohibition results in liability.

35 The Securities Law, art 1 provides: "This Law is enacted in order to standardize the issuing and trading of securities, protect the lawful rights and interests of investors, safeguard the economic order and public interests of society and promote the development of the socialist market economy." See also R Tomasic and J Fu "The securities law of the People's Republic of China: An overview" (January 1999), available at: <http://www.researchgate.net/profile/Roman_Tomasic/publication/228225086_The_Securities_Law_of_the_People's_Republic_of_China_An_Overview/links/540676260cf2c48563b2528a.pdf> (last accessed 8 July 2018).

36 The definition reads: "Inside information shall be the information that is not made public because, in the course of securities trading, it concerns the company's business operation or financial affairs or may have a major effect on the market price of the company's securities. The following information belongs to inside information: (1) The major events listed in the second paragraph of Article 67 of this Law; (2) Company plans concerning distribution of dividends or increase of capital; (3) Major changes in the company's equity structure; (4) Major changes in security for the company's debts; (5) Any single mortgage, sale or write-off of a major asset used in the business of the company that exceeds 30 per cent of the said asset; (6) Potential liability for major losses to be assumed in accordance with law as a result of an act committed by any of a company's directors, supervisors, or senior executives; (7) Plans concerning the takeover of listed companies; and (8) Other important information determined by the securities regulatory authority under the State Council to have a marked effect on the trading prices of securities."

37 "The following persons are persons with knowledge of inside information on securities trading: (1) Any director, supervisor, and senior executive of an issuer; (2) Any shareholder who holds not less than 5 per cent of the shares in a company and any director, supervisor, and senior executive of such shareholder, and any actual controller of a company and any director, supervisor, and senior executive of such controller; (3) Any issuer-holding company and any director, supervisor, and senior executive of such company; (4) Any person who is able to obtain company information concerning the trading of its securities by virtue of the position he holds in the company; (5) Any staff member of the securities regulatory authority, and any other person who administers the securities issuing and trading pursuant to his statutory duties; (6) Any relevant staff member of any sponsor, securities underwriting company, stock exchange, securities registration and clearing institution and securities service organization; and (7) Any other person specified by the securities regulatory authority under the State Council."

38 For instance, the CSRC's internal guidance document, the "Notice of the CSRC regarding the printing and distribution of the (provisional) guide for the recognition and

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An array of sanctions is provided as part of the regulator's enforcement toolkit. The CSRC has a mandate to investigate and penalize violations relating to securities market regulations and laws. Article 180 of the Securities Law provides that the regulator is empowered to act through its Administrative Sanctions Committee to enter premises, copy and seal records, and interview the suspect's personnel, among other things. It can also issue administrative orders, such as to freeze assets until investigations are complete.

For the administrative sanctions option, negligence is sufficient for insider trading to be penalized. Where the illegal income is less than RMB 30,000 (approximately USD 4,400), an administrative penalty of between RMB 30,000 and RMB 600,000 is provided. More egregious cases are subjected to criminal penalties under the Criminal Law[39] and conviction may result in imprisonment of up to ten years and a fine of up to five times the illegal income.[40] To sustain a conviction, it must be proved that the defendant appreciates that what they possess is material inside information that is not in the public domain. To that end, recklessness or actual intention is a requirement for insider trading liability under article 14 of the Criminal Law. Furthermore, according to article 73 of the Securities Law, the subjective test requires proof that the defendant knew of that fact, while the objective test demands establishment of the fact that the offender ought to have reasonably known that they had material non-public information. Much as the criminal liability option forms part of the broader enforcement option, the CSRC has no power to prosecute insider trading. Instead, it refers all suitable cases to the police and prosecutors for investigation and prosecution. The fact that a violation is being so referred does not extinguish the regulator's right to deal with the matter administratively.

Also available are civil or private remedies under articles 76, 77 and 79 of the Securities Law. These allow for compensation for anyone who has been prejudiced or suffered loss arising from insider trading, market manipulation or

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confirmation of insider trading behaviour in the securities market" (2007), gives a broader interpretation of art 74 of the Securities Law, to include partners and spouses, any party involved in a merger, acquisition or reorganization and their subordinates or personnel. Also captured are the issuers of a listed company, the controlling shareholder of the issuer, as well as entities under the control of the issuer and the directors, board and management.

39 The Criminal Law of the People's Republic of China, adopted by the second session of the fifth National People's Congress on 1 July 1979 and amended by the fifth session of the eighth National People's Congress on 14 March 1997.

40 Id, art 180 states: "… [insider traders] shall be sentenced to not more than five years in prison or criminal detention, provided the circumstances are serious. They shall be fined, additionally or exclusively, a sum not less than 100 per cent and not more than 500 per cent as high as their illegal proceeds. If the circumstances are especially serious, they shall be sentenced to not less than five years and not more than 10 years in prison. In addition, they shall be fined a sum not less than 100 per cent and not more than 500 per cent as high as their illegal proceeds."

fraud. More specifically, article 76 provides that, "[w]here any insider trading incurs any loss to investors, the actor shall be subject to the liabilities of compensation according to law". These provisions simply build on earlier pronouncements that initially brought to the fore the existence of civil enforcement. These include the Notice on the Issues of the Trial of Civil Damages Cases Arising from Misrepresentations in the Securities Markets of 2002 as well as the Provisions Governing the Trial of Civil Damages Cases Arising from Misrepresentation in the Securities Markets of 2003.[41] Much as that option exists, civil litigation is still absent and, as such, the enforcement of insider trading is characterized by a heavy dependency on the CSRC's administrative and criminal sanctions.[42]

Supplementing the traditional prohibition are rules enacted by the CSRC through which executives and large shareholders are banned from trading ten days before earnings preannouncements[43] and 30 days before a formal financial report is issued;[44] this is known as the trading ban regulation. In line with this, the Hong Kong Stock Exchange has gone further and lengthened the period of the board of directors' trading ban from 30 to 60 days before the announcement of year-end earnings. This has been said to be more effective than traditional enforcement measures in that, while the traditional measures entail longer years of investigation that often yield little success, the trading ban regulation has been said to be effective in constraining insider trading by thwarting trading prospects during an informational advantage period, within which insiders are most likely to trade on the basis of nonpublic information.[45]

Enforcement

The CSRC is the primary securities regulatory authority under the State Council. As stated earlier, much as it has made great strides in setting up a regulatory framework aimed at creating a cleaner securities market:[46]

41 It is of interest that these two documents were issued by the Supreme People's Court, not by securities regulators.

42 C Zhu and L Wang "Insider trading under trading ban regulation in China's A-share market" (2015) *China Journal of Accounting Research* 1 at 10; Shen "A comparative study", above at note 30; H Huang "Insider trading and the regulation on China's securities market: Where are we now and where do we go from here?" (2012) 5 *Journal of Business Law* 379; Bainbridge (ed) *Research Handbook*, above at note 30 at 320.

43 See generally Zhu and Wang, ibid.

44 See generally ibid.

45 This is in keeping with the trend in other jurisdictions. For instance, in 1977 the United Kingdom outlawed insider trading two months before an earnings announcement. Likewise, much as there is no mandatory insider trading ban regulation, the risk of litigation is said to have spurred companies voluntarily to introduce and implement policies that amount to a trading ban. See generally Zhu and Wang "Insider trading", above at note 42.

46 See Huang "The regulation of insider trading", above at note 27.

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> "[In] China's securities market, there are many serious problems that need to be addressed. The problem of insider trading is an excellent example of the difficulties that Chinese regulators must confront … Although the Chinese securities law has made a quantum leap in the area of insider trading, China's efforts to combat insider trading are far from satisfying. As discussed below, there have been a very limited number of reported insider trading cases so far, contrasting strikingly with the perceived prevalence of insider trading activities in the market."[47]

To put that critical observation in context, it is important to outline the enforcement trend undertaken by the CSRC.

As Chinese financial markets have grown, so has the number of insider trading cases. More particularly, there has been a steady growth in incidences of the offence, with global calls for the heightened enforcement of prohibitions of insider trading playing a major role in this shift. Much as that is so, enforcement leaves much to be desired and enforcement statistics demonstrate an unconvincing trend. More specifically,

> "only a limited number of insider trading cases have been processed, and the processing cycle is long … From the perspective of regulatory and judicial practices, the CSRC only enforced penalties in 12 insider trading cases from 1990 to 2006 … From 2008 to 2011, it investigated 153 insider trading cases and imposed administrative penalties in only 31 cases, moving 39 cases to the judiciary system. From 2007 to 2011, the courts around the country finished only 22 cases related to insider trading and the administrative penalties and criminal fines in these cases were too light to have any deterrent effects …"[48]

In terms of the criminal enforcement of insider trading law, few cases investigated by the regulator have been subjected to prosecution. For instance, between 2008 and 2012, 1,458 cases were investigated by the CSRC but only 125 of those were referred to the Economic Crime Investigation Division and these were not exclusively insider trading cases but also other types of case, such as cases of market manipulation or undue information disclosure.[49] It is this limited number of cases that have earned China much criticism and

47 Huang "An empirical study of the incidence", above at note 28 at 2–3; NC Howson "Enforcement without foundation? Insider trading and China's administrative law crisis" (2012) 60/4 *American Journal of Comparative Law* 955; Huang *International Securities Markets*, above at note 32 at 19–22; Huang "The regulation of insider trading", above at note 30.

48 Zhu and Wang "Insider trading", above at note 42 at 10. See also Shen "A comparative study", above at note 30; Huang "Insider trading and the regulation", above at note 42.

49 For enforcement statistics, see for instance the CSRC's annual reports, available at: <http://www.csrc.gov.cn/pub/csrc_en/informations/publication/201307/P020130716578944216513.pdf> (last accessed 3 September 2018); Bainbridge (ed) *Research Handbook*, above at note 30 at 320.

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growing calls for the use of criminal sanctions to boost deterrence.[50] Nonetheless it is worth pointing out that, despite the low numbers, it is fair to say that China has attained significant convictions that have underscored its intention to curb insider trading.[51]

Despite these gloomy findings, a notable achievement since the inception of the prohibition of insider trading relates to a period from 2011 that saw the investigation of over 40 insider trading cases, the imposition of a total of ¥335 million (approximately USD 50 million) in fines and the debarring of eight investors. Also notable is that, before 2008, the only criminal conviction for insider trading took place in 2003.[52]

South Africa

One distinction between the Chinese and South African approaches is that the South African prohibition of insider trading has a much older history. Section 70 of the Companies Act 46 of 1926 has been celebrated as South Africa's first attempt at curtailing insider trading. That provision basically required all companies to maintain a register of shares and debentures held by their directors.[53] On account of the fact that section 70 did not unequivocally prohibit insider trading, among other flaws, that statute was said to be ineffectual and was repealed by the Companies Act 61 of 1973 (the 1973 Companies Act). In contrast, section 233 of the 1973 Companies Act introduced an explicit proscription of insider trading[54] and provided that its contravention amounted to a criminal offence, attracting a penalty of imprisonment for a period not exceeding two years or a fine not exceeding R8,000 (approximately USD 540) or both a fine and imprisonment.[55] However, the 1973 Companies

50 See for instance Shen "A comparative study", above at note 30; Bainbridge, ibid; Y Zhen *China's Capital Markets* (2013, Elsevier) at 154.

51 Although the prohibition came into effect in 1997, the first criminal enforcement actions against insider trading arose in 2003, in the cases of *Ye Huanbao* and *Gu Jian*. However, the conviction of Huang Guangyu in 2010, in which Mr Huang was sentenced to nine years in prison and fined RMB 0.6 billion yuan (approximately USD 88 million), led to the highest penalty imposed so far in China's insider trading enforcement history. See Shen, ibid; Bainbridge, id at 320.

52 See Huang "The regulation of insider trading", above at note 30.

53 See generally MS Blackman et al *Commentary on the Companies Act* (2004, Juta) 1 Revision Service 1 at 5-375.

54 Sec 233 stated: "Every director, past director, officer or person who has knowledge of any information concerning a transaction or proposed transaction of the company or of the affairs of the company which, if it becomes publicly known, may be expected materially to affect the price of the shares or debentures of the company and who deals in any way to his advantage, directly or indirectly, in such shares or debentures while such information has not been publicly announced on a stock exchange or in a newspaper or through the medium of the radio or television, shall be guilty of an offence."

55 1973 Companies Act, sec 441.

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Act also proved to be inadequate and therefore ineffective in combating insider trading.[56]

To remedy these perceived weaknesses, the Companies Amendment Act 78 of 1989 (Companies Amendment Act) came into effect and, under section 440F, introduced an insider trading prohibition,[57] which nonetheless retained the criminal sanctions. For the first time, an offence was introduced based on knowingly (directly or indirectly) trading on the basis of unpublished price-sensitive information in respect of a security. The penalty for breaching the insider trading prohibition was increased sharply from R8,000 to a maximum of R500,000 (approximately USD 34,000), and the imprisonment term rose from two to ten years, or both a fine and imprisonment.

Owing to defects such as enforcement failures, section 440F also proved to be ineffectual.[58] This catalogue of failures gave credence to extensive criticism of the insider trading regulatory environment. For instance, in an apt summary of the enforcement process during that era, one commentator observed that, "the attempts to create liability and administer sanctions have been clumsy and have resulted in an unsystematic basis for the control of insider trading with borrowed legislation to clarify the concepts of an insider and insider information, questionable procedures to monitor, apprehend and penalize the practice, and penalties which may not be adequate deterrents in all cases".[59]

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56 Besides being so bulky and complex, so as to be counterproductive to the legislative objective, the Nel Commission said the regulatory regime was unsuitable and constituted a patchwork and piecemeal framework. See "The final report of the Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa" (April 2001), available at: <http://www.justice.gov.za/commissions/comm_nel/chapter1_7.pdf> (last accessed 3 September 2018). For a discussion of the regulatory regime, see generally FHI Cassim "Introduction to the new Companies Act: General overview of the act" in FHI Cassim et al *Contemporary Company Law* (2nd ed, 2012, Juta) 1 at 3. See also Chitimira "A historical overview", above at note 15; Kawadza "Extra-judicial enforcement", above at note 15; Botha "Control of insider trading", above at note 15; Jooste "A critique", above at note 15; H Kawadza "The liability regime for insider dealing violations in South Africa: Where we have been, where we are" (2015) 27/3 *South African Mercantile Law Journal* 383.

57 Sec 440F provided: "Prohibition of use of fraud, deceit or artifice in dealings in securities. (1) Any person who, directly or indirectly, in connection with the purchase or sale of any security - (a) employs any devise, scheme or artifice to defraud any person; (b) makes any untrue statement of a material 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; or (c) engages in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, shall be guilty of an offence."

58 Botha "Control of insider trading", above at note 15; S Botha "Increased maximum fine for insider trading: A realistic and effective deterrent?" (1990) *South African Law Journal* 504; P Osode "The new South African Insider Trading Act: Sound law reform or legislative overkill?" (2000) 44 *Journal of African Law* 239.

59 Botha "Control of insider trading", id at 18.

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Such weaknesses led to the enactment of the Insider Trading Act in 1999. Besides introducing the Insider Trading Directorate, dedicated to considering insider trading cases, the new statute brought a new penal regime. For the first time insider trading was now a statutory civil offence for which the then Financial Services Board (FSB, now called the Financial Conduct Authority) could bring an action before the High Court. The new regime empowered the then FSB to sue for the profits made or the losses avoided through illicit transactions. In addition, the regulator could impose a penalty of three times the amount that had been made or avoided. Another radical change was the introduction of a strategy through which funds extracted through a successful action could be distributed to persons who had been prejudiced by the transaction.

South Africa's re-integration into the international global economy necessitated a review of laws governing its financial markets. Thus in 2005 the Securities Services Act 36 of 2004 (the Securities Services Act) repealed the Insider Trading Act 135 of 1998.[60] This move was associated with the introduction of the Enforcement Committee (which was empowered to impose administrative penalties), and a fine-tuning of the insider trading and other market abuse prohibitions in a bid to increase investor confidence, improve financial market efficiency and maintain a stable market environment.[61] The civil penalties regime introduced under the Insider Trading Act was retained, supported by a discretionary criminal law penalties option. Notably there was a shift towards stringent enforcement,[62] as evidenced by the substantial

60 For an in-depth discussion of the changes brought about by this act, see for instance RD Jooste "Insider dealing in South Africa: The criminal aspects" (1990) 4/1 *De Ratione* 21. An additional reason for this shift was that, "[d]espite the fact that the Insider Trading Act's civil action process was successful, it did not nevertheless address the problems besetting enforcement. It was unduly time-consuming, with matters taking too long to be concluded as a consequence of the delays incumbent therewith. It was common cause between all involved with such processes that an effective and credible financial regulatory system must be capable, at least in its design, to produce reasonably speedy results. Furthermore, the penalty provisions of the civil action process were seen as not appropriate for forms of market abuse other than insider trading, such as making false statements and price manipulation": *Pather and Another v Financial Services Board and Others* (2014) 3 All SA 208 (GP) (*Pather*), para 41. See generally Chitimira "A historical overview", above at note 15; Botha "Control of insider trading", above at note 15; Jooste "A critique", above at note 15.

61 See N Müller "New Securities Services Act aligns South Africa with best international regulatory practice", available at: <www.fsb.co.za/Departments/capitalMarkets/Documents/New%20Securities%20Services%20Act%20aligns%20South%20African%20with%20best%20international%20Regulatory%20practice.pdf> (last accessed 8 July 2018).

62 This is evidenced by, inter alia, the regulator's proclamation that, by enacting the Securities Services Act, the regulator was moving away from a passive, back-office approach to a proactive, risk-based approach. See for instance "Financial Services Board to deal more harshly with non-compliance" (25 July 2012), available at: <https://www.cover.co.za/financial-services-board-to-deal-more-harshly-with-non-compliance/> (last accessed 6 September 2018).

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increase (under section 115(a) of the Securities Services Act) of the potential criminal fine from R2 million to a fine not exceeding R50 million. The objective of curbing insider trading is a joint effort between the Financial Conduct Authority's Directorate of Market Abuse and the Johannesburg Stock Exchange's Market Practices Department, especially its Surveillance Department, which is tasked with preventing and detecting market abuse activities such as insider trading.[63]

The global trend towards revisiting the financial sector's regulatory framework to avert the recurrence of the debilitating effects of the 2007–09 financial crisis has mainly been reflected in the repeal of the Securities Services Act and the enactment of the Financial Markets Act 19 of 2012 (FMA). The FMA builds on the previous regime under the Securities Services Act. More particularly, in section 78 the new statute has retained the definitions of "insider" and "inside information". Nonetheless, it is worth noting that the FMA has widened the realm of the insider trading prohibition and its penalties. More specifically, section 78(3) introduced a new offence of dealing with an insider while knowing that the person is an insider. Furthermore, it increased the maximum penalties for both primary and secondary liability. However, in a clear departure from the previous penal provisions that were built around civil sanctions, section 82(1) of the FMA states: "any person who contravenes [the insider trading prohibition] … is liable to pay an administrative sanction not exceeding - (a) the equivalent of the profit that the person, such other person or such insider, as the case may be, made or would have made if he or she had sold the securities at any stage; or the loss avoided, through such dealing; (b) an amount of up to R1 million".

It is clear therefore that, while section 77 of the Securities Services Act empowered the judiciary to impose sanctions (at the instance of the FSB through a civil suit), that function has now been assumed by the regulator through the administrative enforcement mechanism. It is has been argued that this policy shift (from civil to administrative sanctions) was largely influenced by lessons learned from the enforcement experiences of other jurisdictions, especially the United Kingdom:

> "As with South Africa before the introduction of the Financial Markets Act, the UK penalised market abuse under a civil sanctions system. However, a market cleanliness analysis concluded that the civil sanctions system was connected, not with an improvement, but with deterioration in market behaviour. The culmination of such criticism has been a reconsideration of the market abuse penalty framework and the introduction of inter alia, a more punitive enforcement agenda aimed at engendering 'credible deterrence'. … it can be

63 See FHI Cassim "An analysis of market manipulation under the Securities Services Act 36 of 2004 (part 2)" (2008) *South African Mercantile Law Journal* 177 at 196; H Chitimira "Overview of selected role-players in the detection and enforcement of market abuse cases and appeals in South Africa" (2014) 1 *Speculum Juris* 107.

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> justifiably averred that the criticism of the UK's civil regime justifies the new administrative system brought about under the Financial Markets Act."[64]

Obviously, the change in strategy may also have been motivated by the need to dispose of cases expeditiously, an advantage of the administrative route. It is argued further that such administrators are better acquainted with the regulations at issue, than judges who are detached from the financial sector industry and as such may not be proficient in its provisions and customs. Likewise, the evidentiary requirements for proving fault for administrative enforcement purposes are not as stringent as with the other routes. Another advantage is that administrative remedies such as disgorgement are associated with the compensatory convenience of transmitting resources (part of the disgorged profits) to the prejudiced investor. Besides disgorgement of an offender's profits, the FSB makes use of naming and shaming as an enforcement tool.[65] The theory is that status and reputation are essential assets to an individual or firm and that losing these aspects can have repercussions that exceed the effect of the most stringent sanction that a court could impose.[66] In other words "it is not the severity of the sanction in financial terms, but the amount of public shame that it invokes, which is the most important motivator of compliance".[67] Furthermore, such naming and shaming serves as a statement to warn the public about the shenanigans of the exposed party. By so doing, the FSB effectively communicates guidance to the public.

That should not be interpreted to mean that there is no longer recourse to the civil enforcement route. Section 84(2)(c) of the FMA empowers the FSB to institute "such proceedings" as are contemplated in chapter X and, according to section 85(1)(c)(i), the Directorate of Market Abuse has the power to "institute proceedings as are contemplated in section 84(2)(c) in the name of the board". As such the FSB can still make use of the civil court process under section 83 to obtain relief such as interdicts or attachment orders.

Enforcement

It is therefore clear that South African legislative history and reform have mainly been spurred by the need to address shortcomings in the enforcement processes. To that end, the enforcement of securities regulations has also been

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64 Kawadza "The liability regime", above at note 56 at 395.

65 The FMA, sec 84(2) empowers the regulator, "if the disclosure is in the public interest", to publicize disciplinary decisions of the enforcement committee.

66 R Macrory "Regulatory justice: Making sanctions effective" (November 2006), available at: <http://webarchive.nationalarchives.gov.uk/20121205164501/http://www.bis.gov.uk/files/file44593.pdf> (last accessed 8 July 2018).

67 J van Erp "The impact of 'naming and shaming' on business reputations: An empirical study in the field of financial regulation" (cited with permission), available at: <http://regulation.upf.edu/utrecht-08-papers/verp.pdf> (last accessed 8 July 2018); H Kawadza "A discussion of the extra-judicial enforcement of securities regulation in South Africa in light of the public interest theory" (2015) 29/1 *Speculum Juris* 49.

subjected to constant refinement, necessitated by the need to create deeper and cleaner markets. It has been argued that an effective mechanism for understanding the efficacy of regulatory processes is look at enforcement actions at "street level" or "on the ground".[68] This section endeavours to outline and analyse the enforcement trends in South Africa regarding various pieces of legislation mentioned above.

A salient feature of the enforcement process has been the absence of criminal prosecution for insider trading. Although stringent penalties have always been prominently pronounced in the statutes, unlike in China where there is a record (albeit meagre) of prosecutions, attaining prosecutions in South Africa has been problematic. In South Africa it is the prerogative of the Director of Public Prosecutions,[69] not the securities agency, to undertake prosecutions; however, over the years, in South Africa as in many other jurisdictions,[70] authorities have found prosecuting complex financial offences such as insider trading to be a time-consuming and difficult activity. The limits of criminal law as an enforcement tool are best summed up by Kgomo, J who states:

> "Prosecutors do not always possess the necessary specialised knowledge or skills or expertise to prosecute regulatory contraventions or transgressions, which might result in active and serving private legal practitioners being approached and appointed as *ex officio* prosecutors of such matters. Furthermore, the stigma attached to a criminal conviction will always or often mean that industry professionals are likely to fight a relatively minor contravention tooth-and-nail."[71]

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68 See for instance RA Kagan "Understanding regulatory enforcement" (1989) 11 *Law and Policy* 8; AC Mertha *The Politics of Piracy: Intellectual Property in Contemporary China* (2007, Cornell University Press) at 178; EJ Cárdenas "Globalization of securities enforcement: A shift toward enhanced regulatory intensity in Brazil's capital market?" (2012) 37/3 *Brooklyn Journal of International Law* 807; L Sucharow "Mapping misconduct: An overview of significant SEC enforcement actions since the passage of the Sarbanes-Oxley Act of 2002" (annual SEC sanctions report, November 2012), available at: <https://www.secwhistleblowerадvocate.com/wp-content/uploads/2012/01/MappingMisconduct-OverviewofSignificantSECEnforcementActions_November2012-1.pdf> (last accessed 8 July 2018).

69 See National Prosecuting Authority Act 32 of 1998, sec 20.

70 It is argued that this is "not peculiar to South Africa alone as only a few jurisdictions had a good record of successfully exploiting criminal law as an enforcement tool in market offences. The onerous need to satisfy the *mens rea* elements and the equally challenging evidentiary requirements of the crime were at the forefront of features that impeded the common use of the criminal justice system as a tool of enforcing market regulations": Kawadza "The liability regime", above at note 56 at 387. See also AK Rider "Civilising the law: The use of civil and administrative proceedings to enforce financial services law" (1995) 3/1 *Journal of Financial Crime* 11; A Ogus "Enforcing regulation: Do we need the criminal law?" in H Sjögren and G Skogh (eds) *New Perspectives on Economic Crime* (2004, Edward Elgar) 42.

71 *Pather*, above at note 60, para 33.

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This is especially true and explains why, in South Africa, despite the proscription of insider trading as long ago as 1973 by the Companies Act, 61 of 1973, the paucity of criminal enforcement is still prominent.[72] It follows therefore that "[i]f the effectiveness of legislation which makes certain conducts an offence is measured in terms of the number of successful prosecutions for that offence, then the regulation prohibiting insider trading [in South Africa] has failed".[73]

In the absence of criminal sanctions, it has been hoped that the shift to civil enforcement would better reinforce the regulator's goals of minimizing insider trading. Features such as the possibility for remedies enabling investors to recover losses emanating from market abuse by individuals and firms as well as the low evidentiary requirements needed to prove contravention of the statutes, which are associated with civil sanctions, have always been touted as justifying the preference for civil liability as an enforcement tool.[74]

That shift was evidently concomitant with intensified enforcement efforts by the FSB. For instance, according to media releases by the FSB's Enforcement Committee, the enactment of the Insider Trading Act led, for the first time, to violations of the insider trading prohibition actually being sanctioned and a marked drop in the prevalence of suspicious trades.[75] According to such media announcements, 23 cases involving contraventions of section 6 of the Insider Trading Act were instituted by the regulatory agency in the High Court between 1999 and 2005. Much as the act has been acclaimed as a massive statement of intention, this option nonetheless translated into a record number of settlements between the FSB and those who would have contravened the insider trading provisions.[76] As with the criminal prosecution route, proceedings instituted under this technique have not resulted in any

72 Id, para 37. See also Kawadza "The liability regime", above at note 56; Luiz "Insider trading regulation", above at note 15; H Kawadza "A discussion of some aspects of the regimes for the regulation of insider dealing in South Africa and the United States of America" (2015) 59/2 *Journal of African Law* 1; FSB "Enforcement actions" (2013), available at: <https://www.fsb.co.za/enforcementCommittee/Pages/enforcementActions.aspx> (last accessed 8 July 2018).

73 Luiz, ibid. For a critique of this environment, also see Kawadza "The liability regime", ibid.

74 For instance it has been argued that understanding that "[s]uccessful enforcement actions in civil suits will encourage compliance, stimulate securities enforcement efforts in other contexts, and facilitate a consensual understanding of sanctionable behaviour. Criminal enforcement under this scenario would become the 'heavy club' to be swung against those deemed sufficiently blameworthy to deserve imprisonment": MI Steinberg "Emerging capital markets: Proposals and recommendations for implementation" (1996) 30 *International Lawyer* 715 at 725. See also K Mann "Punitive civil sanctions: The middle ground between criminal and civil law" (1992) 101/8 *Yale Law Journal* 1795; MM Cheh "Civil remedies to control crime: Legal issues and constitutional challenges" (1998) 9 *Crime Prevention Studies* 45.

75 See *Pather*, above at note 60, para 38. See also Kawadza "The liability regime", above at note 56 at 388.

76 See generally *Pather*, id. See also Kawadza, ibid.

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case being decided by the South African courts through the civil enforcement process.[77] It follows therefore that no corpus or precedent pertaining to civil court judgments has been handed down on an insider.

As stated above, under section 82 of the FMA, a breach of the insider trading prohibition results in an administrative sanction. Nonetheless, the FSB is still empowered, under section 84(2)(c) of the FMA, to institute "such proceedings" as are contemplated in chapter X, in addition to the power under section 85(1)(c)(i) under which the Directorate of Market Abuse can "institute any civil proceedings as contemplated in this Chapter". Of late, despite the availability of other options as stated in section 84(2)(c) and mainly because of the flaws associated with the civil process, the FSB's enforcement trend has gravitated towards a preference for administrative sanctions. These have been largely expressed through settlements, a process preferred under the previous regime under the civil enforcement approach of the Securities Services Act. It has been argued that:

> "Since the South African regulator's enforcement endeavors are hampered by resources limitations, it has pragmatically sought to generate compliance through higher levels of co-operation. What seems to underpin the predilection for co-operation seems to be considerations such as limitations linked to the traditional enforcement options such as civil sanctions as well as the usual absence of external pressures for assertive enforcement … Other compelling considerations for the popularity of settlement hinge on some attractive aspects stretching from, the fact that settling out of court resolves issues expeditiously and is not constrained by excessive litigation costs or lengthy court trials which are often exacerbated by backlogs. In addition, there is need for the FSB to maintain positive and stable working relationships and settling is one way of accomplishing this. The assumption therefore seems to be that the benefits of settling exceed the costs involved."[78]

The problem with that approach is that settlement entrenches the problems identified in the previous regime, more particularly the failure to discharge the public interest through *res judicata* or the creation of precedent. Further, as can be seen from the FSB's annual reports, settlements between the FSB

77 See S Luiz and KV Der Linde "Financial Markets Act and the regulation of market abuse" (2013) 25 *South African Mercantile Law Journal* 458; Kawadza "A discussion", above at note 67; Kawadza "The liability regime", ibid.

78 Kawadza "A discussion", id at 57. For the benefits of this approach, see: "GE Hitachi settlement will maintain 'positive working relationship' with NRC" (27 January 2014) *NucNet*, available at: <http://www.nucnet.org/all-the-news/2014/01/27/ge-hitachi-settlement-will-maintain-positive-working-relationship-with-nrc> (last accessed 8 July 2018); *FSB Annual Report 2008*, available at: <https://www.fsb.co.za/Departments/communications/Documents/FSB%20Annual%20Report%202008.pdf> (last accessed 8 July 2018).

and market offenders are made on a "without admitting or denying" liability basis through which the respondent or defendant continues to maintain the appearance of innocence despite paying a fine.[79] Nonetheless, that approach has been celebrated locally and internationally[80] as having enabled the expeditious resolution of cases, especially given that those cases are generally determined on paper.

Also in the FSB's administrative enforcement tool-kit is disgorgement.[81] As in China, privately instituted actions are not a feature of the South African enforcement landscape; instead, there is an innovative and effective scheme through which, after recovering its costs, the regulator dispenses part of the fine and profit disgorged from the offender to persons who would have suffered loss as a result of insider trading.[82] Although disgorgement is an effective remedy that serves as an effective substitute of common law remedies such as restitution, it is nonetheless flawed in that offenders are rarely liable to contribute much, as 50 per cent or more of the settlement payment usually comes from insurance. Similarly, disgorged proceeds are not usually directly derived from the offending individual. This is because directors' and officers' liability policies provide the primary source of insurance funding and these policies are paid for by the corporation. Equally, the disgorged amount can easily be absorbed by a large company and become a part of doing business, by for instance pecuniary penalties being factored into the company's operating risks or overhead costs provisions.[83]

As stated above, disclosure, more particularly naming and shaming offenders, has served as an alternative enforcement tool for the South African regulator.[84] In line with that strategy the FSB has made numerous public pronouncements of alleged or actual odious market conduct. With the coming into effect of the Insider Trading Act 135 of 1998, six market offenders were extensively publicized and, through that disclosure, it was shown that share prices fell by 8–20 per cent within a week. In another case, the falling share price emanating from the FSB's disclosure led to the company being

79 CL Ford "Toward a new model for securities law enforcement" (2005) *Administrative Law Review* 757; Kawadza "A discussion", ibid.

80 See *Pather*, above at note 60, para 46.

81 See FMA 2012, sec 82; *FSB Annual Reports 1999–2000* and *FSB Annual Reports 2009–10*, available at: <https://www.fsb.co.za/Departments/communications/publications/Pages/fSBAnnualReports.aspx> (last accessed 8 July 2018).

82 Luiz and Der Linde "Financial Markets Act", above at note 77; Kawadza "A discussion", above at note 67; Chitimira "A historical overview", above at note 15; Botha "Control of insider trading", above at note 15.

83 Kawadza, ibid; R Romano "The shareholder suit: Litigation without foundation?" (1991) *Journal of Law and Economics* 55.

84 See the FSB's enforcement trend from its annual reports 2000–10, above at note 81.

compelled to abandon its takeover strategy.[85] As such, through disclosure the consumer is empowered to influence company behaviour.[86]

DISCUSSION

It cannot be doubted that China has made considerable progress in regulating the conduct of players in its securities markets. Nevertheless, when it comes to combating insider trading, there is evidence of under-enforcement and much still needs to be done to ensure that its regulatory and supervisory regimes meet the objective of creating cleaner and fairer securities markets. Such a gloomy perception is not without substance. It has been observed that insider trading "is arguably a reason for China's lacklustre stock market. It also provides cover for other kinds of corrupt behavior and is a stumbling block in China's effort to build a sound market economy based on the rule of law".[87] Much as there might be will on the part of the regulator to revamp the sector, "[t]hree difficulties stand in its way: a weak foundation of the rule of law, weak supervisory powers and institutional obstacles. Although China's criminal law and securities law both set out the parameters of insider trading, its definition remains too broad. The punishment spelled out is also too light to act as a deterrent. Investigating such crimes can also take up resources that China

85 S Malherbe and N Segal "Corporate governance in South Africa" (paper presented at the Trade and Industrial Policy Strategies Annual Forum, Muldersdrift, 2001), available at: <http://www.tips.org.za/files/Corporate_Governance_in_South_Africa.pdf> (last accessed 6 September 2018).

86 For possible justification for this approach in South Africa, see generally CJ Milhaupt "Reputational sanctions in China's securities market" (2008) *Columbia Law Review* 929; J Armour, C Mayer and A Polo "Regulatory sanctions and reputational damage in financial markets" (28 December 2011), available at: <https://econresearch.uchicago.edu/sites/econresearch.uchicago.edu/files/paper.pdf> (last accessed 8 July 2018); van Erp "The impact of 'naming and shaming'", above at note 67; J van Erp "Reputational sanctions in private and public regulation" (2008) *Erasmus Law Review* 145; DM Kahan and EA Posner "Shaming white collar criminals: A proposal for reform of the Federal Sentencing Guidelines" (1999) *Journal of Law and Economics* 365. For the possible unintended consequences of public disclosure, such as enticing disgraced firms and individuals to go underground, see JM Karpoff and JR Lott "The reputational penalty firms bear from committing criminal fraud" (1993) *Journal of Law and Economics* 757; B Fisse and J Braithwaite *The Impact of Publicity on Corporate Offenders* (1983) 246; DA Skeel "Shaming in corporate law" (2001) *University of Pennsylvania Law Review* 181; C Parker "The 'compliance' trap: The moral message in responsive regulatory enforcement" (2006) *Law and Society Review* 591.

87 H Shuli "Time for China to crack down on insider trading" (18 June 2014) *Caixin online*, available at: <https://www.caixinglobal.com/2014-06-18/time-for-china-to-crack-down-on-insider-trading-101010515.html> (last accessed 8 July 2018). See also K Pistor and C Xu "Governing stock markets in transition economies: Lessons from China" (2005) 7/1 *American Review of Law and Economics* 184; BL Liebman and CJ Milhaupt "Reputational sanctions in China's securities market" (2008) 108 *Columbia Law Review* 929.

does not have, especially when compared with mature markets like the United States."[88]

Those challenges are exacerbated by the investigatory, enforcement and judicial environment within which the regulator operates. Besides financial and human resource constraints, as a public enforcer the CSRC's effectiveness is also impeded by its lack of accountability and independence.[89] Equally prejudicial is the fact that insider trading involves high ranking government and party cadres whom the CSRC, being subordinate to the government, has limited capacity to discipline.[90] In keeping with its communist ethos, the Chinese government exercises top-to-bottom control over institutions such as the CSRC and, since the government is the largest investor in securities traded on the two exchanges,[91] the government finds it convenient to interfere in the regulator's activities and has a large say on who should be punished by the regulator. Such decisions are often made on the basis of political expedience.[92] This is best illustrated by a lack of transparency in the regulator's enforcement processes. For instance, it has been recorded that the CSRC's disciplinary hearings are often conducted during closed-door sessions on the pretext that some of the information pertaining to the offence might amount to state or business secrets.[93] To that end, the public is not privy to such hearings. Neither does the CSRC issue annual reports to the public concerning its enforcement activities.[94] In addition, although they are deemed to be

88 Shuli, ibid.

89 Bainbridge (ed) *Research Handbook*, above at note 30 at 324; Wei "The development of the securities market", above at note 29; Huang "The regulation of insider trading", above at note 27; Pistor and Xu "Governing stock markets", above at note 87; H Cheng "Insider trading in China: The case for the Chinese Securities Regulatory Commission" (2008) 15/2 *Journal of Financial Crime* 165.

90 P Gottschalk *Investigation and Prevention of Financial Crime: Knowledge Management, Intelligence Strategy and Executive Leadership* (2010, Gower Publishing) at 124; M Zhang *Chinese Contract Law: Theory and Practice* (2006, Martinus Nijhoff Publishers) at 18; L Cao, IY Sun and B Hebenton *The Routledge Handbook of Chinese Criminology* (2013, Routledge) at 244.

91 Huang "The regulation of insider trading", above at note 27; Pistor and Xu "Governing stock markets", above at note 87; Cheng "Insider trading in China", above at note 89.

92 Pistor and Xu, ibid; Cheng, ibid.

93 See editorial "China's anti-corruption campaign is not all it seems" (4 August 2014) *Financial Times*, which avers that: "The way justice is dispensed in China undermines the claim that this is an even-handed exercise. Courts are not independent but answer to the Communist party. Judgments are often reached behind closed doors." See also V Bath "China, international business, and the criminal law" (2011) 91/3 *Asian-Pacific Law & Policy Journal* 1; DCK Chow "How China's crackdown on corruption has led to less transparency in the enforcement of China's anti-bribery laws" (2015) 49 *University of California, Davis* 685; Cheng "Insider trading in China", above at note 89; NC Howson "Enforcement without foundation? Insider trading and China's administrative law crisis" (2012) 60/4 *American Journal of Comparative Law* 955; S McDonell "AM-Stern Hu case to be heard behind closed doors" (22 March 2010) *ABC*, available at: <http://www.abc.net.au/am/content/2010/s2852121.htm> (last accessed 8 July 2018).

94 Cheng, ibid.

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self-regulatory, the Shanghai and Shenzhen Stock Exchanges are also undermined by political interference and are not autonomous.[95] These factors have spurred calls for the transformation of the current approach and especially for a transition towards a rule of law approach to regulation of the industry.[96]

Furthermore, courts are not fully independent but are frequently influenced by the government and the leaders of the Communist Party. Most fundamentally courts are overladen by a heavy workload, lack of expertise relating to securities litigation and the operational judicial interpretation of the laws. These factors drastically limit the number of insider trading cases that the courts can handle and heavy backlogs are not uncommon.[97] Much as the CSRC has penalized a number of cases, some scholars are sceptical, arguing that most of these are largely symbolic and imposed "probably to foster the illusion that it was able to adequately enforce the insider trading law".[98]

In comparison, China seems to take a more pro-active stance against insider trading through criminal prosecution. Nonetheless, what emerges from this discussion is that both South Africa and China face challenges in their fight against insider trading. Probably the greatest indication of this is the minimal number of convictions for insider trading in China and, worse still, the paucity of insider trading convictions in South Africa. Such a state of affairs indicates that, when compared to China, South Africa has had little success in combating insider dealing.[99] In fact, the absence of a rich corpus of decided cases may have an impact on the development of the law pertaining to the containment of insider trading. This is especially so in view of the experience of more mature markets, which demonstrates that "the laws of insider trading have evolved through a number of judicial opinions in a process of assembling the common law adjudication rather than statutory interpretation and promulgation".[100] Without such judicial pronouncements it goes without saying that South African efforts aimed at containing insider trading are arguably being hindered.

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95 Pistor and Xu "Governing stock markets", above at note 86; Liebman and Milhaupt "Reputational sanctions", above at note 87; Cheng, ibid; Wei "The development of the securities market", above at note 29.

96 See for instance D Zhou "Promote the standardization and development of China's securities market by attaining perfection of securities legislation" in *Collection of Essays and Articles from the International Symposium on Securities Law* (1997, China Securities Regulatory Commission, Publishing House of Law) 7; Liebman and Milhaupt, ibid.

97 Shen "A comparative study", above at note 30; Huang "Insider trading and the regulation", above at note 42; Zhu and Wang "Insider trading under trading ban", above at note 42.

98 Cheng "Insider trading in China", above at note 89 at 171.

99 For a discussion of this, see for example Chitimira "A historical overview", above at note 15; Kawadza "A discussion", above at note 67; Kawadza "The liability regime", above at note 56; Botha "Control of insider trading", above at note 15; Jooste "A critique", above at note 15; Luiz "Insider trading regulation", above at note 15.

100 B Stephen "An overview of US insider trading law: Lessons for the EU?" (January 2005), available at: <http://ssrn.com/abstract=654703> (last accessed 8 July 2018).

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Much as reported cases indicate that China and South Africa have made inroads in bringing offenders to justice, it is reasonable to argue that the number of reported insider trading cases does not represent a comprehensive picture, nor are they a true reflection of the prevalence of insider trading activities in these countries' markets and, in fact, the limited number of reported incidences does not bode well for endeavours aimed at deterring future violations.

That should not detract from the accomplishments that these fairly young regimes have made since proscribing insider dealing.[101] In any case, prosecuting this offence has always proved to be a challenge, particularly owing to the evidentiary requirements needed to obtain a conviction.[102] That China and South Africa have made slow progress to this effect is in no way peculiar to them alone; history has shown that their more mature counterparts who are endowed with sophisticated investigatory and regulatory devices are still tainted by poor records of cracking down on insider trading.[103] With limited resources, Chinese and South African regulators face many challenges and have to allocate available resources effectively to combat insider trading offences so as to maintain their reputation as financial centres in the BRICS bloc as well as to retain investor confidence in their markets. It should also be noted that, for as long as the offence of insider trading is rooted in people's hubristic nature, even with well-crafted laws and stringent penalties aimed at the offence, eradicating insider trading will always be a challenge.[104] Regulators will have to play catch-up to offenders' sophisticated schemes

101 Historically states have not found it easy to prosecute insider trading. For instance, commending the enforcement efforts made by China as compared to other more developed economies, *The Economist* had this to say: "One successful insider trading case puts China streets ahead of some far more developed markets. Switzerland and Italy have yet to bring a successful prosecution under their insider trading laws. Japan has nabbed just one culprit since it banned the practice back in 1989": "Turfing insider-traders out" (16 July 1994) *The Economist* at 67.

102 See generally R Tomasic and B Pentony "The prosecution of insider trading: Obstacles to enforcement" (1989) 22 *Australian and New Zealand Journal of Criminology* 65; V Goldwasser "The enforcement dilemma in Australian securities regulation" (1999) 27 *Australian Business Law Review* 482. China has mooted getting round the evidentiary hurdle by adopting an approach used in jurisdictions such as France, which reverses the burden of proof. This would apply in cases of insiders who would be deemed to possess material inside information until they prove the contrary. See CSRC "Guide on insider trading" (2007), art 14. See also Huang "Insider trading and the regulation", above at note 42 at 388.

103 See MF Semaan and M Adams "Is insider trading a necessary evil for efficient markets? An international comparative analysis" (1999) 17 *Company and Securities Law Journal* 220; Goldwasser, ibid; Tomasic and Pentony, ibid; Huang "An empirical study", above at note 28.

104 HK Chan, RSY Chan and JKS Ho "Enforcement of insider trading law in Hong Kong: What insights can we learn from recent convictions?" (2013) 28 *Australian Journal of Corporate Law* 271.

and, unless resources are made available, attaining regulatory objectives will always be an overwhelming exercise.

CONCLUSION

This article has sought to identify and understand the possible similarities and differences between the legal systems in the prohibition of insider trading in South Africa and China. The principle purpose has been to kick-start the process of ensuring consistency in the regulation of capital markets within the BRICS countries. It is hoped that engaging the issue through a comparative exposition of the strategies adopted in South Africa and China to combat market abusive conduct, especially insider dealing, would form the first step towards enhancing the transparency of the regulatory environments in these jurisdictions, an element that is core to the growth and development of sound, safe capital markets within the BRICS economic bloc. With the current trend of financial globalization through trading blocs such as BRICS, there is a need not only for the standardization of regulation, but also the enforcement of the regulation of securities markets laws. Furthermore, it is hoped that, by highlighting regulatory and enforcement processes pertaining to insider trading in these two jurisdictions, policy makers, investors and other relevant stakeholders will be empowered to make informed decisions as they seek to benefit from the objectives of the BRICS coalition.